

ROBBING MARY TO PAY PETER AND PAUL: THE ADMINISTRATION'S PAY-FOR-PERFORMANCE SYSTEM

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL WORKFORCE,
POSTAL SERVICE, AND THE DISTRICT
OF COLUMBIA

OF THE

COMMITTEE ON OVERSIGHT
AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

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ROBBING MARY TO PAY PETER AND PAUL: THE ADMINISTRATION'S PAY-FOR-PER- FORMANCE SYSTEM

TUESDAY, FEBRUARY 12, 2008

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL
SERVICE, AND THE DISTRICT OF COLUMBIA,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:05 p.m., in room 2154, Rayburn House Office Building, Hon. Danny K. Davis (chairman of the subcommittee) presiding.

Present: Representatives Davis of Illinois, Norton, Sarbanes, and Kucinich.

Staff present: Tania Shand, staff director; Lori Hayman, counsel; LaKeshia Myers, clerk; Mason Alinger, minority deputy legislative director; and Alex Cooper, minority professional staff member.

Mr. DAVIS OF ILLINOIS. The subcommittee will come to order. I know that the ranking member is on his way from Texas, and, of course, depending on where you are in Texas, that could be coming a long ways. But we will go ahead and proceed with the hearing.

Let me welcome members of the subcommittee, hearing witnesses, and all of those in attendance. I welcome you to the Federal Workforce, Postal Service, and the District of Columbia Subcommittee hearing, "Robbing Mary to Pay Peter and Paul: The Administration's Pay-for-Performance System."

The purpose of the hearing is to examine the executive branch's implementation of pay-for-performance systems.

Hearing no objection, the Chair and ranking member and subcommittee members will each have 5 minutes to make opening statements, and all Members will have 3 days to submit statements for the record.

Good afternoon, and to the ranking member and subcommittee members and all of those present, welcome to the subcommittee's first hearing of the second session of the 110th Congress. Today's hearing continues the subcommittee's examination of the implementation of pay-for-performance systems at various Federal agencies.

Last March, the subcommittee held a hearing on Federal personnel reforms, followed by a hearing in May on the personnel and pay reforms implemented at the Government Accountability Office [GAO].

Today we turn our attention to the pay-for-performance systems at the Securities and Exchange Commission and the Internal Revenue Service. We will also take a look at the pay-for-performance system that the Office of the Director of National Intelligence would like to impose on the Intelligence Community.

The implementation of these systems must be evaluated with the same intensity that the Bush administration and other pay-for-performance proponents advocated that these systems will be implemented.

The title of the hearing, "Robbing Mary to Pay Peter and Paul," reflects our intent to personalize the impact these systems have on Federal employees. Our work force is made up of individuals sharing a commitment to public service with personal goals and needs. They should not be viewed as or treated as a bunch of bureaucrats who can be driven to better performance by the prospect of monetary rewards.

The title also helps explain how the administration's pay-for-performance system really works. Under the system, Mary, who is a good performer and meeting established performance expectations, may not receive a cost-of-living increase [COLA], needed to offset inflation because her increases are needed to reward Peter and Paul, who were subjectively judged to be slightly better performers. That is the aspect of pay for performance that is so infrequently discussed; that in the absence of a significant increase in funds, performance-based increases are often funded by denying or reducing other employees' COLAs and bonuses. Also, if Mary is an African American, the likelihood of her being adversely impacted by the subjective application of the performance standards is increased.

Next year, after his agency has conducted a market-based study, Peter will be classified as overpaid. Though Peter, with 30 years of service, has been a good performer, he will receive a small bonus, but no COLA. Bonuses are not counted toward base pay, which will affect Peter's high three and, consequently, his retirement benefit.

After a year or two, Peter, Paul and Mary are demoralized, and their teamwork has suffered. They are uncertain about their pay, have little faith in the system, and are looking for jobs in agencies that do not have a pay-for-performance system.

Peter, Paul and Mary are representative of real Federal employees whose pay and retirement are being similarly affected as we speak. If these systems are not fair and equitable, transparent and credible, and do not have the—buy-in of Federal employees, I do not believe that they have a place in the Federal Government.

Federal agencies cannot say that they did not know that credibility, employee buy-in and equity were key to the successful implementation of these systems. These issues were raised up front by this subcommittee and others, yet agencies are failing in all these areas. Further, these systems do not appear to retain employees or increase their performance as the administration advertised.

I ask unanimous consent that the Treasury Inspector General for the Tax Administration report on the IRS's pay-for-performance system be submitted for the record along with arbitrator James M. Harkless' decision that the pay-for-performance system at the SEC

resulted in discrimination against African-Americans and employees who are 40 and older.

Today's witnesses are here to help us evaluate these systems and, where needed, to recommend corrective measures.

[The prepared statement of Hon. Danny K. Davis follows:]

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STATEMENT OF CHAIRMAN DANNY K. DAVIS AT THE SUBCOMMITTEE ON FEDERAL WORKFORCE AND POSTAL SERVICE, AND THE DISTRICT OF COLUMBIA HEARING ON

“ROBBING MARY TO PAY PETER AND PAUL: THE ADMINISTRATION’S PAY FOR PERFORMANCE SYSTEM.”

February 12, 2008

Good afternoon, Ranking Member Marchant and subcommittee members, and all of you present in the audience today. Welcome to the subcommittee’s first hearing of the 2nd session of the 110th Congress.

Today’s hearing continues the subcommittee’s examination of the implementation of pay-for-performance systems at various federal agencies. Last March, the subcommittee held a hearing on federal personnel reforms, followed by a hearing in May on the personnel and pay reforms implemented at the Government Accountability Office (GAO).

Today we turn our attention to the pay-for-performance systems at the Securities and Exchange Commission (SEC) and the Internal Revenue Service (IRS). We will also take a look at the pay-for-performance system that the Office of the Director of National Intelligence would like to impose on the intelligence community. The implementation of these systems must be evaluated with the same intensity that the Bush Administration, and other pay-for-performance proponents, advocated that these systems be implemented.

The title of the hearing, “Robbing Mary to Pay Peter and Paul”: The Administration’s Pay for Performance System,” reflects our intent to personalize the impact these systems have on federal employees. Our workforce is made up of individuals sharing a commitment to public service, with personal goals and needs. They

should not be viewed or treated as bureaucrats who can be driven to better performance by the prospect of monetary rewards.

The title also helps explain how the administration's pay-for-performance system really works. Under that system, "Mary", who is a good employee and meeting established performance expectations, may not receive a cost of living increase (COLA) needed to offset inflation because her increase is needed to reward "Peter" and "Paul", who were subjectively judged to be slightly better performers. That is the aspect of pay-for-performance that is so infrequently discussed; that in the absence of a significant increase in funds, performance-based increases are often funded by denying or reducing other employees' COLAs and bonuses. Also, if Mary is an African American, the likelihood of her being adversely impacted by the subjective application of the performance standards is increased.

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Peter, Paul and Mary are representative of real federal employees whose pay and retirement are being similarly affected as we speak. If these systems are not fair and equitable, transparent and credible, and do not have the buy in of federal employees, I **do not** believe they have place in the federal government.

Federal agencies cannot deny knowing that credibility, employee buy-in, and equity were key components to the successful implementation of these systems. These issues were raised upfront by this subcommittee and others, yet, agencies are failing in all these areas. Furthermore, these systems do not appear to retain employees or increase their performance – as the Administration advertised.

Today's witnesses are here to help us evaluate these systems, and, where needed, to recommend corrective measures.

Thank you.

Mr. DAVIS OF ILLINOIS. Now I would like to ask Delegate Norton if she has a statement that she would like to make.

Ms. NORTON. Yes, Mr. Chairman, beginning with expressing my gratitude that you have continued to do a great deal of due diligence here. I just regret that the subcommittee continues to be ignored, because it's going to make the task before us harder, but inevitably I want to say a few words about why I think the outcome is assured.

Now, even after the GAO debacle, we now have this administration trying essentially to move the same pay systems to what amounts to a half of the work force. When I say "debacle," I don't consider getting a union a bad thing, but I get the GAO does. Of course, as the COLA for 2008 is restored, there is more work for this Congress to do.

Let me first say a word about standards. As I read what the administration seeks to do, I had worse than a feeling of *deja vu*, because these issues have been litigated and settled for decades. To show you how far afield you are and where I come from, it certainly is not that there is no conceivable way for pay for performance to be done; nobody has even tried to implement what the courts have said you have to do if you want to create new standards.

As it turns out, these matters came forward first in the discrimination laws, but the courts have said they apply across the board.

Simply stated—and here is decades of court of appeals and Supreme Court law—simply stated, let me just move to the private sector first, if you want to use a pay system, a promotion system, a testing system, or any other term and condition of employment, it must be race- and sex- and age-neutral, end of litigation.

I don't know whether the administration enjoys a class action, but that's what it's going to get any day now, and class actions that will inevitably lose.

Members of Congress, I have said, please save us some money and listen to the subcommittee, although I assure you that what the administration is doing now is courting not litigation, but legislation. That's the rule. If any of our witnesses can tell us that rule has been revised or changed, I would like to hear it, since I make it my business to keep up with Supreme Court litigation.

Now, if that is the rule that was developed mostly in private-sector litigation, let's add on to it government, Federal, State or local government and ask what would the rule there be? I think we can agree it would at least be what the rule is for the private sector, but—and here is where the administration is brain dead, if you would forgive me—this is a Civil Service system. Read my lips, Civil Service system. It wasn't formed that way because someone woke up and said this is the only way to do government. It came out of hard experience with corruption, to be sure. But its main importance today is that the government is subject to due process, the due process clause of the fifth amendment. That's why, for example, you can fire a private-sector employee, but a public-sector employee has to have a hearing.

Why would you have to do that? Because the fifth amendment kicks in, the Constitution kicks in when there is State action. The

State action is the government employing people, and certain due process standards adhere.

This administration has never understood the difference between a Civil Service system and a private system. I have just told you that even the private system now has to operate under race-, sex- and age-neutral standards.

As if that weren't enough, what is truly hard to understand is how the administration would believe, given the actions of this Congress, without exception, that it could fail to provide money to reward people in its proposed pay system and take the money from COLAs or locality pay. How in the world does the administration think it has the statutory authority to do that?

Let me cite for you what the Congress does each and every year with COLAs. The administration sends over a COLA. It inevitably divides military from Civil Service. Inevitably, overwhelmingly the Congress passes a COLA for every single civil servant equal to the COLA for the military. Yet the administration believes that it can take some people's COLAs, and that the Congress would just sit by and let that happen.

If the administration wants that to happen, it seems to me it has to talk with the chairman, with the committee and with the Congress, and that would be difficult to effect, but at least we would be having a conversation about what you are after.

So I am here, Mr. Chairman, because I think you are doing the right thing in bringing forward the difficulties we see, but also asking the administration to come in and describe in detail how it is able to skip over just the handful of things that I have pointed out that I regard as huge barriers built into the system, and to hear from experts who might enlighten us so that together we might come to some accommodation and would not have to rely upon, on the one hand, litigation from employees, or, on the other hand, legislation from the Congress of the United States.

Thank you again, Mr. Chairman, for this very important hearing.

Mr. DAVIS OF ILLINOIS. Thank you very much, Delegate Norton. Mr. Kucinich.

Mr. KUCINICH. I want to thank you for holding this hearing, Mr. Chairman. I think it's important that we thank those who work for the government for the work that they do and indicate that they ought to be well paid, but they ought not to be manipulated; that if they are doing a good job, they should be compensated for it, and they shouldn't be pitted against each other in any way.

I want to thank all of you for the work that you do. I came here to make that statement, Mr. Chairman. I am glad you are looking at this, because this is certainly something that deserves to be looked at in the interest of those who serve the same public that we serve.

Thank you.

Mr. DAVIS OF ILLINOIS. Thank you very much.

We will now hear from our witnesses, and I will introduce the first panel.

Our first panel of witnesses is Dr. Charles Tiefer, who is a professor of law at the University of Baltimore School of Law. Prior to joining the University of Baltimore's faculty in 1995, Dr. Tiefer served as Solicitor and Deputy and General Counsel of the U.S.

House of Representatives for 11 years. He is a quoted expert on Federal, governmental and constitutional law.

Dr. Tiefer, thank you so much.

The Honorable J. Russell George was nominated by President Bush and confirmed by the U.S. Senate in November 2004 as the Treasury Inspector General for Tax Administration. Prior to assuming this role, Mr. George served as the inspector general of the Corporation for National and Community Service.

Thank you very much, Mr. George.

Dr. Charles Fay is a professor and chair of human resource management at the School of Management and Labor Relations at Rutgers University. He has worked over the last 5 years as a consultant to the Bureau of Labor Statistics on the National Compensation Survey. He was a Presidential appointee to the Federal Salary Commission and also served as chair of the research committee of the American Compensation Association.

Thank you, Dr. Fay.

Mr. Robert Tobias is currently the director of public-sector executive programs at American University. Mr. Tobias was nominated by President Clinton, and the Senate confirmed him for a 5-year term, as a member of the Internal Revenue Service Oversight Board. The Board has broad and strategic oversight authority, responsibility for the IRS.

Thank you, Mr. Tobias.

Dr. Stan Ridley is president and CEO of Ridley & Associates, a human- and organization-development consulting firm in Washington, DC. Dr. Ridley has served on national training committees and developed training on such topics as managing diversity, performance appraisal and strategic planning.

Dr. Ridley, we thank you.

Mr. Max Stier is the president and CEO for the Partnership for Public Service. The partnership is a nonpartisan, nonprofit organization dedicated to revitalizing the public service through a campaign of educational efforts, policy, research, public-private partnerships and legislative advocacy.

It is the policy of this committee that all witnesses be sworn. So, if you would stand and raise your right hands.

[Witnesses sworn.]

Mr. DAVIS OF ILLINOIS. The record will show that each one of the witnesses answered in the affirmative.

Gentlemen, we thank you all for being here. Of course, the green light indicates that you have 5 minutes in which to summarize your statement, which is already in the record. The orange and yellow light indicates that your time is running down, and the red light indicates that it's time to stop.

We thank all of you again for being here, and we will begin with Dr. Charles Tiefer.

STATEMENTS OF CHARLES TIEFER, PROFESSOR, UNIVERSITY OF BALTIMORE SCHOOL OF LAW; J. RUSSELL GEORGE, INSPECTOR GENERAL, U.S. TREASURY TAX ADMINISTRATION; CHARLES FAY, PROFESSOR, SCHOOL OF MANAGEMENT AND LABOR RELATIONS, RUTGERS UNIVERSITY; ROBERT TOBIAS, DIRECTOR, PUBLIC-SECTOR EXECUTIVE PROGRAMS, AND DIRECTOR, ISPPI, SCHOOL OF PUBLIC AFFAIRS, AMERICAN UNIVERSITY; STANLEY RIDLEY, PRESIDENT AND CEO OF RIDLEY & ASSOCIATES, LLC; AND MAX STIER, PRESIDENT AND CEO, THE PARTNERSHIP FOR PUBLIC SERVICE

STATEMENT OF CHARLES TIEFER

Mr. TIEFER. Thank you, Mr. Chairman, and members of the subcommittee. I am a professor at the University of Baltimore Law School, and the author of books and articles and testimony before House and Senate committees on Federal employment policies.

In the past year, since my last testimony on these pay-for-performance systems, the rollout of these systems has revealed serious costs and impacts. First and most dramatically, we have seen this year that they pose systemic discrimination risks. Unlike objective governmentwide pay increases, which are race-neutral, these systems work by evaluative ratings, using loose subjective evaluation criteria; for example, whether employees are considered to be “collaborating with others.”

These systems are vulnerable to supervisors’ stereotyping, diversity-disparaging attitudes and issues of communications. Just as in the past, a host of scholarly studies, of which a leading collection is Professor Naff’s book, *To Look Like America: Dismantling Barriers for Women and Minorities in Government*—studies have shown that Federal promotion and discipline is vulnerable to such discriminatory biases when it works by purely subjective and loose evaluative criteria.

Now, the particular finding that we had this year was on September 4th when the arbitrator’s ruling agencywide about the SEC found systemic age and race discrimination. As Stephen Barr of the Washington Post summarized, the ruling “found the SEC pay system led to discrimination against 324 black employees and 1,109 employees who were 40 or older.”

Now, the other agencies who are still aggressively rolling out pay-for-performance systems, from the Defense Department with NSPS to the Intelligence Community, which will testify today, will want to contend that they have set up neutral systems, and they are doing it under plans, and that their officers have the opposite of an intent to discriminate, and that there’s no evidence that they will intend to discriminate. But, as you will read, the SEC says in its statement here today, and as the arbitrator found, the SEC did not have intent to discriminate. Intent to discriminate is not necessary to have discrimination found in an agencywide system. What they had were a set of statistics that showed a prima facie case of rampant age and race discrimination, which followed from their using subjective evaluative criteria without a system to check what that would mean and without validation.

Now, the SEC will also tell you today that they have revamped their program, but the most important lesson they learned, as they

say toward the very end of their statement, is that “the Commission has decided to temporarily separate our performance management system from the merit pay system.”

Translation: They have stopped linking pay to performance. They have spent some years trying to come out with an evaluative system that can work at all, and only then will they consider linking it to pay. By “some years,” they aren’t even going to have the performance system in place for the rest of the Commission under the top levels until around starting 2009. That’s the kind of schedule that an agency soberly sets in this kind of transition, but it’s not the schedule that other agencies are considering.

Are other agencies going to produce numbers similar to the SEC’s? If we were to check, well, absolutely, I am afraid. A study for this subcommittee last year by GAO Strategic Issues Office found that by studying the SES governmentwide, a shockingly low level of minorities in the SES at the Defense Department, half of what is found in the other departments. The governmentwide figure for minorities in the Senior Executive Service is 16 percent; the Defense Department figure a mere 8 percent. That was the testimony given to this committee May 2007 in this GAO report.

The pay-for-performance system’s furthermore disregard just like that shouts that in the Defense Department there’s a big problem in minority manager promotion and recruiting policy. So the pay-for-performance system’s disregard of seniority and experience and evaluations has sent a not-too-subtle signal to withhold raises from older employees, which the SEC arbitrator found led to a case of illegal age discrimination.

Now, you will also hear today that the Intelligence Community is pushing ahead with its program, but you will hear very little of the skeptical and critical congressional oversight provision, section 308 of the Intelligence Authorization Conference Report, which has demanded answers from the DNI about the alarming threat concerning minority and age discrimination in the Intelligence Community, because the intelligence agencies have a history of much worse numbers on minority employees than the civilian departments. If you go back not that far and put it frankly, some of those intelligence agencies were lily white.

Now, is DNI making a recruitment and promotion of minorities a top priority? No. Like the SEC, they are instituting a program of subjective performance evaluations on criteria like, “Do they collaborate with others.”

I might say second that the administration’s no new regular funding basis does what the title of this hearing said: It robs Mary to pay Peter and Paul. I summarize in my testimony why the NSPS recent pay raise does not include regular funding, and I will refer to the balance of my statement.

Thank you.

Mr. DAVIS OF ILLINOIS. Thank you very much.

[The prepared statement of Mr. Tiefer follows:]

NEW PAY-FOR-PERFORMANCE SYSTEMS STRUGGLE WITH THE ADMINISTRATION'S PROVIDING NO NEW REGULAR FUNDING, SYSTEMIC DISCRIMINATION RISKS, AND (UNDERSTANDABLE) LACK OF ACCEPTANCE BY CIVIL SERVANTS

- I. Executive Summary
- II. Overview of Costs and Impacts From: No New Funding, Systemic Discrimination Risks, and Lack of Acceptance
- III. NSPS at DoD
- IV. HCOP at DHS
- V. IRS, IC, TSA and Other Agencies

I. Executive Summary

Thank you for the opportunity to testify on the subject of the new pay-for-performance, personnel systems at the Departments of Defense (DoD), Homeland Security (DHS), and elsewhere.

In the past year, these pay-for-performance systems had serious costs and impacts. First, they have systemic discrimination risks because evaluative ratings, unlike objective government-wide pay increases, are vulnerable to supervisors' stereotyping, attitudes, and communications issues. On September 4, a ruling in an agency-wide grievance arbitration found systemic age and race discrimination among thousands of SEC employees – from universal factors applicable to the other agencies. I recommend this Subcommittee commission a multiple agency study by GAO's Strategic Issues office on minority and age discrimination in several different pay-for-performance systems. Second, the Administration's "no new regular funding" basis, which depends upon diverting funds for government-wide pay increases, has diminished employee acceptance.

Looking at specific agencies, NSPS drew extensive criticism leading to Congress's reducing the diversion of funding to just 40% of the general pay increase. DoD used, for its January raises, a set of distortedly "spun" figures. It inflated these by lumping in non-pay bonuses; translating identical ratings into different raises by nontransparent and somewhat arbitrary methods; and, apparently by tapping irregular fund sources.

MaxHR/HCOP effectively stopped. The IRS IG reviewed the rollout for managers and found, scathingly, "the IRS risks reducing the ability to provide quality service to taxpayers." And, the Intelligence Community's nascent program elicited a skeptical and critical Congressional oversight provision. An OPM December 2007 study conveniently pretended not to notice all the criticism.

The conclusion recommends a GAO study of minority (including age) statistics, making aggregate figures available, and a freeze on further rollout for further evaluation.

Introduction

Thank you for the opportunity to testify on the subject of the new personnel systems, principally pay-for-performance, at the Departments of Defense (DoD), Homeland Security (DHS), and elsewhere. The past year has witnessed the juggernaut of the rollout of these systems lurching on, lacking the resources, transparency, and employee acceptability to avoid large-scale failure. There is no more vital and controversial subject in federal human resources management. Only this Subcommittee can tackle the issue, as it needs to be tackled – government-wide, across the board, taking a broad view of the developments, costs and impacts, and serving particularly as an early warning system for the alarming risks of systemic discrimination in federal pay.

I am Professor of Law at the University of Baltimore Law School since 1995, and the author of a number of pertinent law review and journal studies, and book sections, on federal personnel and related procurement policy, besides testifying in 2003 (Senate) and 2006-2007 (House) about prior stages of these personnel systems.¹

II. Overview of Costs and Impacts From: No New Funding, Systemic Discrimination Risks, and Lack of Acceptance

For this testimony, I have reviewed a number of scholarly and survey studies, and journalistic accounts of new personnel systems. Some of the most relevant ones are cited in footnotes below, including some notably high-quality journalistic reports.

A. Discrimination

Background

Let me briefly summarize the recent history of discrimination risks in general as to federal personnel, before turning to the new pay-for-performance systems in particular. On the one hand, the record of federal personnel policy includes some positives, particularly race-neutral or diversity initiatives.² In general, some personnel policies of the Civil Service, like the GS step-scale for pay raises, functioned either automatically, or otherwise without excess vulnerability to supervisors' subjective stereotyping and attitudes. These policies sometimes furnished minorities with more of a chance of fair

¹ These include sections about personnel in CHARLES TIEFER & WILLIAM A. SHOOK, *GOVERNMENT CONTRACT LAW: CASES AND MATERIALS* (Carolina Academic Press 2d edition 2004 & Supp. 2006). In 1984-1995 I was Solicitor and General Counsel (Acting) of the U.S. House of Representatives, and participated in numerous oversight investigations of federal personnel and procurement policy. I testified on such issues in 2003 before a Senate Government Operations subcommittee, in 2006 before a House Homeland Security subcommittee, and in 2007 before this Subcommittee. I wish to thank Michelle Reichlin, a second-year student of the University of Baltimore Law School, for her major research contributions.

² During the era of Jim Crow, some agencies of the federal government, including the postal service, functioned in some parts of the country as the one substantial employer giving even a semblance of fair employment to minorities. President Truman's Executive Order 9981 in 1948 to desegregate the Armed Forces stands as one of the great historic landmarks in equal opportunity. But the full background has more negatives than positives. See Desmond King, *Separate and Unequal, Black Americans and the US Federal Government* (1995).

treatment in some government departments than in backward parts of the private sector.³ For example, as to simple numbers of hiring (apart from job level), Professor Naff's leading work on the subject noted, "with the exception of Latinos, people of color held proportionately more jobs in the federal civil service than they do in the civilian labor force."⁴

On the other hand, the recent record of federal personnel policy includes disappointing negatives. These center upon aspects with vulnerabilities to supervisors' subjective stereotyping and attitudes. Promotion, which depends upon supervisors' subjective evaluations, is a particular sore point. Minorities "remain underrepresented in the upper grades. . . . although 1.2 percent of Euro-Americans can be found in senior pay jobs, only about one-half of 1 percent of African Americans . . . [and other minorities] can be found at that level."⁵ Numerous studies, including Congressional hearings, found a "glass ceiling" for women and minorities in the government. The explanation: "stereotyping can have a powerful, if surreptitious, impact, including their prospects for advancement."⁶ The same negatives are found in discipline, including discharge, compounded by problems of inadequate communication particularly across racial lines.

As I will note below, the Subcommittee on the Federal Workforce has been commendably developing a record on this subject. Working with GAO's Strategic Issues office, it has gathered government-wide statistics on federal minority employment. This is real progress. This kind of analysis should be extended to pay-for-performance.

The Ruling on Discrimination in SEC Pay-for-Performance, and Its Implications

With that background, we see the systemic discrimination risks in the Administration's pay-for-performance systems. The existing Civil Service GS system distributes the main components of raises neutrally by objective measures, such as by government-wide pay comparability percentage raises. In contrast, under the new pay-for-performance systems, women and minorities lose these objective measures. They receive their pay raises in the same ways as they receive personnel actions, like promotion and discipline, known to have statistical patterns reflecting systemic discrimination risks. That is, minorities receive pay-for-performance evaluative ratings and raises based on their superiors' subjective evaluations. Moreover, those ratings often suffer from inadequate communication, particularly found across racial lines.

Unfortunately, this past year showed the strength of these reasons for concern about systemic discrimination risks in pay-for-performance. A very dramatic ruling occurred in the past year as to the impacts of pay-for-performance: the ruling on September 4 in an agency-wide grievance arbitration that the Securities and Exchange Commission (SEC) discriminated in pay-for-performance merit pay. That SEC ruling found systemic age and race discrimination among the thousands of SEC employees in the proceeding. That was not just a systemic risk of discrimination; that ruling found

³ For an overview, see *Equal Employment Opportunity: The Policy Framework in the Federal Workplace and the Roles of EEOC and OPM*, GAO-05-195 (April 2005).

⁴ Katherine C. Naff, *To Look Like America: Dismantling Barriers for Women and Minorities in Government* (2001), at 84-85. Professor Naff teaches in the department of public administration at San Francisco State University.

⁵ *Id.* at 85.

⁶ *Id.* at 971

actual, agency-wide discrimination against thousands of employees in pay-for-performance.

The SEC had implemented the pay-for-performance system in 2002-2003, the NTEU filed a grievance, and the arbitrator made findings about the extensive statistical evidence. As Stephen Barr of the Washington Post reported, the Arbitrator's ruling "found the SEC pay system led to discrimination against 324 black employees and 1,109 employees who were 40 or older."⁷ GovExec summed up the ruling's findings about race and age bias:⁸

A statistical analysis performed for the union showed that only 16 percent of African-American SEC employees received raises of three steps, while 30 percent of white employees received those maximum raises. Ten percent of African-American employees received no merit-based pay increase, compared to only 6 percent of white employees.

That analysis also revealed that while half of SEC employees were 40 or older, 67 percent of the employees who received no merit-based pay increase fell into that age range, and those older employees received only 45 percent of the three step increases.

Other agencies, from DoD to DHS, will try to duck the distressing implications of the SEC discrimination ruling, namely, that the Administration's pay-for-performance systems are at high risk for systemic discrimination just like what that ruling found agency-wide at the SEC. Let me note something here that I will mention several times. In December 2007, the Office of Personnel Management (OPM) released a so-called "status report" on pay-for-performance.⁹ Some snippets of useful inside information came out, which will be noted where germane. However, the OPM Status Report's nonstop happy-talk rather conveniently omits to mention all the other studies that disconfirm OPM's self-congratulation about pay-for-performance. The SEC is a striking example. The arbitrator's agency-wide ruling about systemic discrimination received major play in the Washington Post, GovExec, BNA, and almost everywhere else covering the personnel world – except in the OPM report's section on the SEC, which does not have a word of discussion (p.29). Discussing the SEC without mentioning the discrimination ruling is like discussing the cruise of the *Titanic* without mentioning the iceberg.

I closely reviewed the arbitrator's extensive ruling, and am struck by how universally the underlying factors apply generally to the Administration's pay for performance proposals. For example, other agencies from DoD to DHS will want to contend that they set up a "neutral" system, that their officers would have the opposite of intent to discriminate, and that there is no evidence they will intend to discriminate. But, the ruling found this, too, at the SEC, and yet the ruling's statistics showed rampant age and race discrimination. The SEC, too, set up a "neutral" system; at the SEC, too, there was no evidence presented that their officers had conscious intent to discriminate; at the

⁷ Stephen Barr, *Bias Found in SEC Pay System*, Wash. Post, Sept. 6, 2007.

⁸ Alyssa Rosenberg, *Arbitrator Rules Against SEC Pay for Performance System*, GovExec, Sept. 7, 2007.

⁹ Office of Personnel Management, *Alternative Personnel Systems in the Federal Government: A Status Report on Demonstration Projects and Other Performance-Based Pay Systems* (Dec. 2007).

SEC, too, the agency maintained that the combination of lack of managerial intent to discriminate, plus a “neutral” rating system, prevented systemic discrimination.

However, the hard statistical agency-wide evidence as to the SEC showed, as similar evidence is only too likely to show, about the IRS, NSPS and so on – and possibly even about the SES, the apex of the personnel system -- that in practice the awarding of pay-for-performance raises discriminated along age and race lines. At the SEC, as similarly would be seen about other government agencies, it “was implemented without providing adequate guidelines to employees and supervisors, and was executed in a haphazard and inconsistent fashion across the agency.” At the SEC, as similarly would be seen about NSPS and so on, the criteria for pay-for-performance left room for loose subjective evaluation (e.g., whether employees “collaborate with others”), a wide opening for discriminatory stereotyping, diversity-disparaging, and similar patterns of discriminatory evaluation. And, at the SEC, as in the NSPS and so on, the pay-for-performance system’s “encouragement” of disregarding seniority – and experience – in evaluations can readily morph into a not-too-subtle way of withholding raises from older employees, tantamount to illegal age discrimination.

The problems analyzed by Professor Naff with both stereotyping and inadequate communication throughout the federal government as the source of discrimination apply with great force to pay for performance. Counterbalance was not built in at the SEC, and similarly not built in at the other agencies from DHS to NSPS. That is, there was no positively accounting for the value of experience and diversity to counterbalance age and race stereotyping. Above all, NSPS and similar systems lack the kind of transparency and accountability that would check the all-too-easy lapses into discriminatory patterns, and facilitate corrective action when they occur.

Recommendation: GAO’s Strategic Issues Office Should Do a Follow Up Study on Minority Pay-for-Performance Statistics

In light of the ruling about agency-wide pay-for-performance age and race discrimination, there is a vitally necessary study for this Subcommittee to task the GAO to do. This Subcommittee should commission a multiple agency study on the cross-cutting human capital issue of minority and age discrimination statistics in several different pay-for-performance systems.

Let me note some background. This Subcommittee has already commissioned, and received, several excellent studies by the GAO Strategic Issues offices on minority statistics in different agencies. I have carefully reviewed two May 2007 GAO Strategic Issues office studies: *Data on Hispanic Representation in the Federal Workforce*,¹⁰ and, *Human Capital: Diversity in the Federal SES and the Senior Levels of the U.S. Postal Service*.¹¹

These GAO Strategic Issues office studies for this Subcommittee show the tremendous value of multiple agency studies on minority statistics. On the technical level, they utilize the invaluable resource of analysis of the Office of Personnel Management’s (OPM) Central Personnel Data File (CPDF). GAO has years of experience validating and utilizing the CPDF database. The value of CPDF statistical studies is beyond question. On the substantive level, these studies show the kind of

¹⁰ GAO-07-493R.

¹¹ GAO-07-838T.

unarguable statistical conclusions that put policy debates about minorities on a sound framework. For example, look what we see with one glance at the government-wide tables on SES women and minorities statistics, overall (Table 1), and then broken out by 24 agencies (Table 2):

Which (in Sept. 2006)	SES numbers	% Women	% Minorities
Government-wide	6,110	28.4	15.9
Dept' of Defense	1,133	21.0	8.0

In other words, DoD has only *half* the level of minorities in its SES than is found government-wide. Moreover, these particular government-wide numbers include DoD. So the situation, bluntly, is that it takes just about all the other government agencies put together, to have enough minorities in their total SES, to counter-balance the very low levels of minorities in DoD SES and produce the government-wide figure of 15.9%. Put another way, DoD alone sets back the entire government effort to have an SES like that civilian work force. This strongly suggests the need for other DoD personnel treatment, such as pay-for-performance, to receive similar statistical evaluation.

GAO may, or may not, have to analyze a great deal of data beyond the CPDF to study the pay-for-performance minority (including age) statistics, depending on what there is and what GAO does. But, even if it has to go beyond the CPDF, the task is feasible. In January 2004, the GAO Strategic Issues office did a multi-agency analysis of pay-for-performance. *Human Capital: Implementing Pay for Performance at Selected Personnel Demonstration Projects* (Jan. 2004).¹² The key data included "rating and payout data, cost data, [and] rating distribution data from OPM's Central Personnel Data File (CPDF). . ."¹³ Among the multiple systems to examine, one of the most important is the SES one, because it is at the apex of the federal personnel structure. For GAO Statistic Issues office, this study would utilize the analytic approach found in its SES minorities study and its pay-for-performance study. For other agencies, such as NSPS and the systems for IRS managers or DHS or both, it would utilize similar data.

One of the most important questions for the GAO to analyze is the minority (including age) statistics on which employees receive the largest raises – the limited number of employees receiving a top evaluation. Recall that the SEC ruling made the key finding that whites were receiving those top evaluations and top raises disproportionately often compared to minorities. Since the bulk of NSPS employees (as discussed below) receive the mid-level "3" rating, the key question is whether some groups are disfavored in receiving the high ratings. That would raise the question of whether there is a prima facie case of discrimination along the lines found in the SEC ruling.

B. Employee Non-Acceptance, Driven By "No New Funding"

As I have testified before, a pay-for-performance system has little chance for success in the face of intense employee non-acceptance. New studies this past year

¹² GAO-04-83. One of the two co-requestors was the chair of the Subcommittee on Civil Service and Agency Organization (Rep. Jo Ann Davis). The other was the Senate counterpart.

¹³ *Id.* at 41.

confirmed this. The IBM Center's report, written by Professor James R. Thompson,¹⁴ noted the following:

Gain and Ensure Employee Acceptance

. . . . Employees inevitably compare features of the new system to the old. In the federal context, the "old" is represented by the GS. . . .

The pay-for-performance element of most payband systems is, at least on its face, disadvantageous to employees to the extent that pay increases that historically have been automatic now become contingent. Agencies moving to paybanding have often had to overcome resistance In attempting to gain employee acceptance, many agencies have incorporated features that emulate those of the GS. For example, GS employees generally receive a yearly general pay increase, called the "comparability increase" Most of the systems reviewed here continue to grant the general pay increase to the vast majority of their employees consistent with GS practice. [As for the] . . . general pay increase monies be[ing] included in the pay pool and distributed on the basis of performance [I]t would be harder to gain employee acceptance of such a practice given the inevitable comparison with GS employees.¹⁵

Although leaving the Congressionally-provided automatic comparability general pay increase alone, and obtaining new funding, is thus a common feature of even the half-successful federal pay-for-performance systems, and experts warned about it being "harder to gain employee acceptance" if tinkered with, that is precisely how the Administration funded NSPS.

To the extent that NSPS drew on funding other than diversion of the government-wide pay increases, it has spelled out nothing publicly. Moreover, to the extent it drew on such funding, it may have drawn on temporary irregular sources not dependable in future years (i.e., temporary slack in the system, such as pay for positions that remain vacant). That is a special "one-time introductory funding" finagle that sugar-coats the introduction of NSPS but insures a later let-down when the temporary irregular funding stops. Since, in terms of a stable basis for future operation, NSPS has not obtained expressly-dedicated, stable new funding, for pertinent purposes, this testimony speaks simply of a "no new funding" basis.

Predictably, nothing has so surely and intensely diminished employee acceptance of the Administration's pay-for-performance systems as the Administration's rollout of those systems without new funding for performance-rated raises. This requires an explanation, for which NSPS provides the biggest example.

DoD refused to make NSPS's rollout depend on new funding for performance-rated raises. Rather, the rollout occurs without new separate funding for performance-rated raises. Instead, DoD wrests away a portion of the Congressional appropriation provided to be distributed automatically government-wide by the even-handed, neutral formulas of the GS, and diverts that for NSPS-manipulated distribution as pay-for-performance raises. In other words, employees who would automatically get the

¹⁴ James R. Thompson, *Designing and Implementing Performance-Oriented Payband Systems* (IBM Center for the Business of Government 2007).

¹⁵ *Id.* at 16 (underlining added).

Congressional-formula pay raise, most of which simply keeps their pay from shrinking in real terms due to inflation, do not get the raise and see their real pay shrink. Employees who get NSPS-manipulated distribution may not get more than they would by automatic formulae. Such employees may do no more than break even and avoid an inflationary reduction in real pay.

This “no new funding” method is perhaps the single biggest downside of NSPS, for the reduction of pay, in real terms, to a large percentage of employees sharply depresses its already limited acceptability. In any event, in 2007 DoD kept insisting on a high percentage – 50% -- of the pertinent automatic government-wide pay raises would get diverted to NSPS. As described below, employee labor organization efforts and Congressional oversight got this changed to the compromise figure of 40% diversion to NSPS and 60% distributed by the automatic formulae. Were the Administration to have its way, it has said in the past it would like to go to 100% diversion for 2009. If Congress does nothing else this year, it should adopt provisions (in authorizations, appropriations, or both) precluding the threatened 100% diversion of the general pay increase.

III. NSPS at DoD

A. General Criticism of the NSPS Rollout

The relentless rollout of NSPS continued this past year and will continue in 2008, and the past year’s intense criticism of its patent shortcomings has only won limited amelioration and only postponed – until this year and next year – the confrontation with its alarming aspects.

At the start of this Congress, there were some reasons for hope in a slowing of the ill-conceived relentless rollout of NSPS. Originally, the NSPS’s statutory authorization occurred immediately after the 2002 election, at a time of public support for Rumsfeld’s direction.¹⁶ NSPS at DoD had been synonymous with Rumsfeld, whose true belief in his own top-down management has been criticized.¹⁷ The 2006 election, and Rumsfeld’s resignation immediately thereafter, showed that the winds of change were blowing Defense Department management in a less single-minded, more pragmatic direction.

And, during 2007, criticism of the shortcomings of NSPS accumulated. A number of Congressional hearings, before this Subcommittee and elsewhere, exposed this. For example, on March 6, 2007, the newly established House Armed Services Subcommittee on Readiness held that committee’s first oversight hearing on NSPS. Bipartisan and expert criticism poured onto NSPS. Rep. Walter Jones, R-N.C., said: “The shadow of Donald Rumsfeld is still around,” and, “This system was his creation, and I feel like it is another failed policy.”¹⁸ Professor Marick Masters testified about NSPS “I am concerned that there may not be enough money in the pay pool to make the

¹⁶ From the National Defense Authorization Act for FY 2004, codified at 5 U.S.C. sec. 9902(a).

¹⁷ The subject is discussed in Charles Tiefer, *The Iraq Debacle: The Rise and Fall of Procurement-Aided Unilateralism as a Paradigm of Foreign War*, 29 U. Penn. J. Int’l L. (2007).

¹⁸ Quoted in Richard Brown, *Rumsfeld’s Gone, But His Failed Personnel Plan Lives On*, Commentary, Federal Times, March 27, 2007.

received salary increases and/or bonuses meaningful enough to be motivating [T]he process is based heavily on supervisory ratings, and is highly subjective”¹⁹

The GAO issued a report on July 16, 2007,²⁰ rejecting the Defense Department’s claim that implementing NSPS would only cost \$158 million. GAO denounced the artificially low costing of NSPS, finding DoD had deliberately low-balled the estimates by leaving out normally costed-in items like the full salaries for personnel charged with putting the system in place, the cost of general administrative services, research and technical support, rent, and so forth. As a professor of government procurement, I can assure you that when defense contractors bill the government under cost reimbursement contracts, the items the DoD left out to low-ball its NSPS cost estimate are not left out and substantially swell their cost figures.

GAO’s July 2007 report on that budgetary low-balling of NSPS has many worrisome implications that persist to today. NSPS imposes a much greater burden on DoD than acknowledged, and, to hide the higher cost, DoD is inadequately budgeting for it. Inadequate budgeting means diminished acceptance of the system, diminished checks on abuses like discrimination, and diminished benefits to go along with the worsened problems. DoD’s inadequate budgeting is a formula for failure. Moreover, DoD may well be using its costing methods for NSPS as a way to flout Congressional oversight.²¹

On the other hand, a significant legal development occurred. When I testified a year ago, I noted with concern that the District Court ruling against NSPS had been argued in December 2006 before a panel including Judge Brett M. Kavanaugh, who was a deputy for Ken Starr and then served as associate White House counsel in the Bush Administration. I warned that Judge Kavanaugh would give the Administration a victory, something that observers might not expect from the limited legal support for the Administration’s position. And, he did as expected. I take no pleasure in the prediction. The law was much more on the side of the different D.C. Circuit panel that had ruled unanimously, on a similar issue, against the same type of system (then MaxHR) for the Department of Homeland Security.

Still, the Kavanaugh ruling interpreted the NSPS statutory charter as authorizing its most extreme provisions: the labor relations provisions that deprive federal employee labor organizations of key bargaining rights, and the provisions depriving federal employees of key appeal rights for personnel matters. Federal employee labor organizations led by AFGE announced plans to petition the Supreme Court for certiorari as to the Kavanaugh ruling. Also in the wake of that ruling, in June and July, both the House and the Senate moved along provisions to repeal DoD’s authority to move forward

¹⁹ Testimony of Prof. Marick Masters, Subcomm. On Readiness of the House Comm. On Armed Services, March 6, 2007, at 2. Prof. Masters teaches at the Graduate School of Business of the University of Pittsburgh.

²⁰ GAO-07-851

²¹ For an illustration, at the Department of Homeland Security, Congressional oversight in 2006 tried to curb the rollout of MaxHR, but the Administration went ahead with expensive contracts to Northrop Grumman. The MaxHR rollout, and preparation for further rollout, continued on an excess scale because the department put normally costed-in items under other accounts – just as GAO was finding at DoD about NSPS.

on the labor relations portions of NSPS. By December, a version of these had gone into the DoD authorization conference report.²²

B. Congressional Provisions Curbing the NSPS Rollout

Congress moved along provisions to curb the highly counterproductive DoD plan for funding raises for NSPS. DoD had slyly provided extra funding for the token first increment of 11,000 employees who were first covered under NSPS starting in January 2007.²³ But thereafter, DoD refused to make NSPS's rollout depend on new funding for performance-rated raises. This Administration "no new regular funding" method is perhaps the single biggest downside of NSPS, for the limited increase in stable pay, in real terms, to a large percentage of employees sharply depresses its already limited acceptability.

In any event, in September 2007 DoD warned its employees – which shocked them – that NSPS would divert a high percentage – 50% -- of the pertinent automatic pay raises.²⁴ The Washington Post reported many sources, including AFGE, responding that DoD employees would be shocked at such a high percentage of diversion.²⁵ In October, an influential bipartisan letter to Secretary Gates warned that DoD employees "were informed from the outset that for the first year in the NSPS they would at least receive their base pay increase. . . . It would be difficult if not impossible to recruit or retain employees if they knew they could not rely on their promised salaries."²⁶ Already, on July 31, this Subcommittee had held an important oversight hearing, with one of the year's leading factual critiques of pay-for-performance by AFGE Secretary-Treasurer J. David Cox.²⁷

Congress responded by provisions to reduce the diversion to just 40% to NSPS, letting 60% get distributed the across-the-board way, which by December had reached the defense authorization conference report.²⁸ In the face of the AFGE-led court challenge and the extensive critical Congressional oversight, DoD began in the last two months of 2007 to move toward a compromise on NSPS. The first week of January, DoD issued a new fact sheet outlining the compromise, which AFGE President John Gage responded was "acceptable." As FederalDaily said:²⁹

In December, in the face of continued court challenges over NSPS, DoD ditched its effort to curb employee collective bargaining rights. The Pentagon even compromised on pay in the DoD appropriations bill, proposing that all employees, regardless of rated performance, get at least 60 percent of the automatic government-wide pay increase scheduled under the GS system. Only

²² Stephen Losey, *Congress Protects NSPS Employees' Bargaining Rights, Sets Appeals Process*, Army Times, Dec. 10, 2007, at 4.

²³ *Id.*

²⁴ Tim Kauffman, *Pay Reform to Mean Smaller Raises at DoD*, Army Times, Sept. 17, 2007, at 1.

²⁵ Stephen Barr, *Defense Begins Transition to Merit-Based Pay*, Wash. Post, Sept. 17, 2007, at D1.

²⁶ Frank R. Wolf, James P. Moran, & Tom Davis, Letter to Secretary Robert M. Gates of Oct. 10, 2007.

²⁷ Laura D. Francis, *Lawmakers Told of Inequities in Federal Pay But Urged to Reject Alternative Pay Systems*, BNA Government Employee Relations Report, Aug 7, 2007.

²⁸ Stephen Losey, *Congress Protects NSPS Employees' Bargaining Rights, Sets Appeals Process*, Army Times, Dec. 10, 2007, at 4.

²⁹ *DoD Outlines Compromise on NSPS, Issues New Fact Sheet*, FederalDAILY, Jan. 7, 2008.

the remaining 40 percent of congressional allocations for pay increases would be divvied up as raise money under NSPS, reducing the impact of the new system. To date, more than 100,000 of the agency's 700,000 civilian employees have been transferred out of the GS and into NSPS, with more to come.

The DoD Fact Sheet explained this "60-40" split in detail.³⁰

Currently, the Administration still plans to move more than 75,000 DoD employees into NSPS in March, a move called "Spiral 2."

C. Dubious, Heavily "Spun" DoD Figures About the NSPS Pay Increase The Suspect DoD Figures

In January 2008, the Administration's announcement of the NSPS pay increases made a series of exaggerated claims that warrant scrutiny. These Administration claims foreshadow the problems likely to produce a backlash of employee non-acceptance and other problems.

The Administration's announcement consisted of a set of headline figures intensely spun, but without backup, and reflecting a highly non-transparent system. Specifically, the NSPS website announced a headline figure with the misleading terms that, as the Washington Post reported, "The average pay raise under the National Security Personnel System was 5.9 percent plus a bonus that equaled 1.7 percent of base pay, officials said. The combination provided an average 7.6 percent boost in *compensation*."³¹ That "compensation" increase made NSPS sound more generous than Santa Claus.

However, the NSPS figures are quite suspect. First, lumping the bonus in as "compensation" obscures the significant difference. For key purposes, what matters for federal employees is the 5.9 percent average increase to pay. Unlike pay raises, bonuses do not figure into the formula for pensions – pensions being a big part of federal

³⁰ The DoD Fact Sheet explained:

Government-Wide Pay Increase (GPI)

The 2008 Government-wide pay increase (GPI) for Federal employees is 3.5% of which 2.5% is an increase to base salary and 1.0% is for locality pay/local market supplement adjustments. Under NSPS, the GPI is allocated as follows:

- Sixty percent of the base salary increase (or 1.5%) is applied to pay band adjustments for employees who received a final rating of record of 2 or higher.

At http://www.cpms.osd.mil/nsps/docs/FactSheet_2008.pdf.

- Forty percent of the base salary increase (or 1.0%) is allocated to Element 2 of pay pools and paid out as performance-based base salary increases to employees who received a final rating of record of 3 or higher.
- Local market supplement adjustments are granted in the same manner and extent as GS locality pay for employees who received a final rating of record of 2 or higher.

Employees who did not receive a 2007 final rating of record receive the equivalent of the January 2008 GPI.

³¹ Stephen Barr, *For Many Defense Workers, A Day With Some Merit*, Wash. Post, Jan. 25, 2008, at D4.

employment benefits, particularly with a workforce of which much is nearing eligibility for retirement. And, bonuses do not even figure into the base for future pay increases. Bonuses are certainly not a promise, nor even in this context a suggestion or a hope, about what the employees will receive in the paycheck (whether as bonuses or pay increases) after the coming year. Bonuses, in short, are not like pay increases. The NSPS trend away from stable pay increases to unstable, easily non-renewed, temporary bonuses represents an unannounced turn away from a stable pay system hitherto built on the security of continuing pay rates figured into promised retirement benefits. To be realistic, the pay increase has to be figured while taking that temporary 1.7 percent component with a grain of salt.

Second, much of the actual pay raise (putting the bonus aside) had nothing to do with NSPS. Much of it consisted of the basic pay increases mandated by Congress, including sixty percent of the government-wide base salary increase (i.e., 1.5%) and (the equivalent of) locality pay supplements (i.e., an average of 1.0%), that Congress provides to non-NSPS and NSPS employees alike. For NSPS to take credit for the government-wide part of the increase ingenuously steals credit belonging solely to Congress and hijacks it for NSPS – especially considering Congress has tended to appropriate higher levels of such government-wide pay increases than the Administration seeks.

Mystery and Nontransparency

Third, the NSPS website³² suggests DoD translated identical ratings into different raises by nontransparent and potentially arbitrary methods. NSPS's funding mechanism takes away from NSPS-covered employees some GS pay raises (e.g., the Quality Step Increase or QSI, and 40% of the basic pay increase), with this money going into "pay pools." Then, figured differently from one "pay pool" to another, the performance raises (or bonuses) for NSPS-covered employees get distributed out of these "pay pools." From DoD's figures, the pay pools took an average government-wide pay increase of 3.26% (1.0 percent from the 40% of the government-wide pay increase, and 2.26% from the combination of QSI, within grade increases, combined with what would be GS promotions but are now within the pay bands) of base pay; and, thereby provided an average pay increase of 3.4% plus the 1.7% of bonuses. DoD does not spell out the explanation for this gap between 3.26% and 5.1%.

Did the Pentagon come up with temporary irregular funding, apart from the diversion of Congressional appropriated government-wide pay increases, despite its not expressly mentioning this?³³ It seems reminiscent of the finding by GAO that DoD's accounting of the supposedly limited cost of NSPS omitted key items. To the extent NSPS drew on such temporary irregular funding, (e.g., temporary slack in the system, such as pay for positions that remain vacant) it may have drawn on temporary irregular sources not dependable in future years. That is a special "one-time introductory funding" finagle that sugar-coats the introduction of NSPS.

³² Performance Ratings for NSPS Employees Reflect a High Performing Workforce, at http://www.cpms.osd.mil/nsps/feature_stories.html.

³³ Or, did some of it happen another way: Did the 3.26% average include some statistical manipulation, like diverting into the pools what would have been a pay increase to higher-paid senior employees, and distributing it to lower-paid junior ones (this being a way that makes the same amount of money appear as a higher percentage pay increase)?

However, temporary irregular funding insures a morale-killing let-down when the temporary irregular funding stops. The OPM Status Report includes euphemistic but unmistakable warnings about how “cost discipline must be maintained as systems expand and mature;” “There is an assumption of fiscal responsibility and cost discipline”; “OPM will be working with DOD and monitoring payroll cost issues to facilitate NSPS regulation” and “OPM should play a central leadership role . . . [to] support cost discipline”³⁴ That is OPM-speak for: irregular funding will get cut off, and OPM will override managers at DOD to keep all raises down, penalizing the average employees by robbing them of their government-wide pay comparability increases to pay for the limited raises of other. It will take inquiry by this Subcommittee unmask these funding manipulations and worrisome OPM designs.

Basically, the NSPS system has a severe nontransparency problem. Employee evaluations translate into “shares” of what their pay pools distribute as raises. These pay pools can be quite small (OPM says they are “typically representing 75-200 employees”³⁵) and, hence, differ greatly from each other. “Shares” of one pay pool can differ very greatly from “shares” from another pay pool. So unless employee unions can get data on their individual operation, there is no way for employees (or anyone else) meaningfully to follow how pay-for-performance operates.

Yet, under NSPS, employees know little more than their evaluation number on the five-level rating scale,³⁶ and maybe not even that. (DoD appears to regard employees as entitled only to a narrative and not even to their own rating number, a treatment of employees that approaches what occurs in Kafka’s *The Trial*). 57% of employees, says DoD, had ratings that fell in the middle, Level 3, called “valuable performer.” So, the bulk of the compensation increase (including bonuses) went to this swollen middle group. But, this majority of employees have no way of verifying, or even understanding, how their common “level 3” rating led to their sometimes very different raises distributed out of the pay pools, which may be smaller or larger despite that common evaluation rating.

Apparently DoD took the distribution of rating sets from different supervisors, facilities, etc. within each pay pool, and normalized them statistically in some fashion. DoD wanted the aggregate of the different rating sets to fit the amount of funding for raises in that pay pool. None of that data, and none of those calculation steps, are getting disclosed to employees, nor, even in the aggregate, to the employees’ unions, GAO, or this Subcommittee. That means no checking, nor understanding, by employees or by those who normally check such matters – a degree of nontransparency that is the opposite of what is called for in a respectable form of pay-for-performance.

Without revisiting at length the previous discussion about race discrimination, recall the GAO study of racial statistics in the SES in DoD and elsewhere in the government:

Which (in Sept. 2006)	SES numbers	% Women	% Minorities
Government-wide	6,110	28.4	15.9
Dept. of Defense	1,133	21.0	8.0

³⁴ OPM Status Report at 39.

³⁵ OPM Status Report at 40.

³⁶ The five-level rating scale is discussed in the Fact Sheet cited above.

Clearly, the Defense Department has an especially low level of minorities (a mere 8.0 %) in its SES. That makes especially suspect the NSPS system in which raises get determined nontransparently, based on subjective evaluations. Unless NSPS becomes more transparent, it will give rise to the suspicion that the disproportionately white male management, by handling raises subjectively and nontransparently, could be awarding them arbitrarily in a way that will not inspire confidence in minorities.

IV. HCOP at DHS

As of a year ago, although pay-for-performance at the Department of Homeland Security (DHS), formerly known as MaxHR and criticized by testimony of mine in 2006,³⁷ had received major legal rejection by a unanimous D.C. Circuit decision,³⁸ DHS seemed determined to press on. Renamed by DHS as “Human Capitol Operational Plan” (HCOP), it was to set up a pilot project in 2008. And, a generous contract had gone to Northrop Grumman, according to a report by the Congressional Research Service, to support HCOP in 2007.³⁹ Stephen Barr reported in the Washington Post that if the Administration decided to expand the pilot, DHS in 2009 could still seek its old goal of shifting all its employees from the GS to pay banding.⁴⁰

However, it seems that DHS’s pay for performance system finally came to a halt under the climate of public disapproval of such systems in general, and at DHS in particular. This Subcommittee’s hearings, I think it is fair to say, contributed to the realization of that climate. In May 2007, the House adopted H.R. 1648, the FY2008 DHS Authorization bill, putting new life into Congressional oversight of DHS. The bill included a provision that repealed the authority for HCOP. Both the House and Senate versions of the 2008 DHS Appropriations bill included restrictions on funding for HCOP. So, the omnibus appropriation signed into law in January 2008 included such a provision. And, the Administration’s report in late January 2008 to the trial court that, years ago, first rejected that system (then MaxHR, later HCOP), indicated no plans to go ahead with the system.⁴¹

V. IRS, IC, and Other Agencies

³⁷ Before the House Homeland Security Subcomm. On Management, Integration and Oversight, May 18, 2006.

³⁸ *NTEU v. Chertoff*, 452 F.3d 839 (D.C. Cir. 2006).

³⁹ *CRS Report for Congress, Homeland Security Department: FY 2008 Appropriations* (updated Aug. 20, 2007), analyzed DHS reports to Congress to conclude the following: “that the contractor Northrop Grumman Information Technology (NGIT) received a contract worth almost \$3 million dollars to provide services through January 31, 2007, related to program management; pay, performance, and classification; and training, communications, and organizational change management at DHS. According to the [DHS] report, NGIT is being awarded another contract, worth more than \$16 million, to provide services to the department through September 30, 2007, in the same areas identified above and labor relations.”

⁴⁰ Stephen Barr, *A Symbolic Setback to Linking Pay With Performance*, Wash. Post, Feb. 26, 2007, at D1.

⁴¹ Brittany R. Ballenstedt, *Homeland Security Drops Proposed labor Relations Plans*, GovExec, Jan. 17, 2008.

IRS

The IRS started its new personnel system well before the Bush Administration push. Basically, its effort dates back to the 1998 IRS reorganization legislation. IRS implemented it in three phases: March 2001, Senior Manager Payband; November 2001, Departmental Manager Payment (for the “Campuses” or data processing arms); September 2005 (with March 2006 consequential revisions) for the Frontline Manager Payment.

In a report on July 3, 2007, the Treasury Inspector General for Tax Administration completed a major review of the IRS Pay-for-Performance System. Its title summarizes, in mild form, its scathing conclusions: “The Internal Revenue Pay-for-Performance System May Not Support Initiatives to Recruit, Retain, and Motivate Future Leaders.”⁴² More bluntly: “the current System may discourage both managers as well as nonmanagers from applying for management positions.” *Id.* at 2. As a result, “the IRS risks reducing the ability to provide quality service to taxpayers . . .” *Id.* at 1.

Among the problems, the IRS’s Human Capital Office (HCO) failed at trying to devise meaningful bands for frontline managers. So it threw in the towel, kept the GS grades as the bands, and “simply removed the incremental steps within each grade” (*id.* at 3) – just failing to improve on the old system and merely washing out its structure. The “HCO did not establish pay policies and procedures that ensured managers are compensated comparably with IRS employees in the GS Pay System or that the performance-based increases are commensurate with the managers’ performance,” (*id.* at 3), which abandons the supposed value of the change.

Finally, the HCO so botched the rollout that it “decreased morale and increased opposition to some of the provisions of the System.” (*Id.* at 3). Strikingly, “an overwhelming majority of the [IRS Managers’] Associations’ members, who responded to a survey, opposed any plans to reallocate the annual across-the-board pay adjustment . . .” (*Id.* at 4).

The Inspector General’s strongly negative report lends objective, within-the-Administration credence to the criticisms of the Administration’s pay-for-performance systems. In particular, it shows the intensity of non-acceptance surrounding the Administration’s effort to reallocate the regular pay raises rather than supply any real new money. It is notable that the intensity of non-acceptance here is from managers, not lower-grade employees, who presumably start with the natural acceptance of managers, rather than the natural suspicion of employees, for management initiatives.

Looking at this IG report on the IRS, one expects the Administration to run into intense non-acceptance throughout DoD, DHS, and elsewhere, as it tries to implement pay-for-performance without supplying new funding. And what could dishearten the public more, than reading the IG warning that pay-for-performance “risks reducing the ability to provide quality service to taxpayers” – when that is what the public most wants from the IRS. Typically, the OPM Status Report, in discussing the IRS, does not mention the IG report.⁴³

Intelligence Community

⁴² Treasury Inspector General for Tax Administration, Reference Number: 2007-10-106.

⁴³ OPM Status Report at 17.

My testimony last year noted that the Director of National Intelligence (DNI) had announced an intention in 2006, as part of a "Pay Modernization" project, to implement a pay-for-performance system across the disparate elements, some military, and some civilian, of the intelligence community (IC).⁴⁴ As I described, this is cause for concern. The unhappy experience of MaxHR at DHS shows that the Administration's enthusiasm for imposing pay-for-performance across disparate and diverse elements, in the name of security, can do more harm than good.

With particular respect to the intelligence community, pay-for-performance seems a formula for more top-down discipline. To the Administration, which would like to blame intelligence failures on lower-level unresponsiveness, top-down discipline may seem purely beneficial. However, those outside the Administration have tended to be skeptical that, for example, the 2003 fiasco of claiming intelligence showed stockpiles of weapons of mass destruction in Iraq came up from lower-level unresponsiveness, rather than coming down from top-level result-driven manipulation. A similar debate concerns whether the lack of anticipation of 9/11 was disproportionately the fault of lower level failures alone, as the Administration would like to have it, rather than, say, how top figures from the President and Condoleezza Rice down gave insufficient attention and sluggish action to warnings from the CIA and others at the working level.

From the OPM "Status Report," we have some detail about the planning process for the DNI's announced intention.⁴⁵ The Administration approved its plan on October 23, 2007, to be managed by the DNI's Chief Human Capital Officer through an IC Pay Modernization Project Office. It will be chartered by six Intelligence Community Directives, with implementation plans and schedules in the different IC elements.

The past year brought welcome Congressional attention to the DNI's announced intention. The House Intelligence Committee moved a provision, Section 307, in the annual intelligence authorization, to require detailed reporting before implementing a pay-for-performance system. In conference, the version that moved in December 2007 fine-tuned the House provision, in what became section 308 of H. R. 2081, Conf. Rept. 110-478 (153 Cong. Rec. 14462, 14465 (Dec. 6, 2007)). The provision envisages the element-by-element implementation. It requires particular attention to many aspects of great interest: budgeting; standards; consultation with employee associations; and, impact on women and minorities, among others.

I hope both the Intelligence Committee, and this Committee, continue their invaluable oversight. The elements in the section 308 reporting are a welcome outline of the focuses of such oversight. For example, the reporting must address the budgeting for the pay-for-performance system. As discussed in this testimony, the Administration proceeded with NSPS without new regular funding, particularly diverting 40% of the governmentwide pay comparability increase. This has a deleterious effect on employee acceptance and amounts to Administration self-sabotage of the effort. Congress generously funds the IC budget, but as with DoD, there has been a regrettable tendency to spend too much of that on big, lucrative contractor projects like satellites, and too little on personnel. And, Congress must not forget the unhappy past experience of pay-for-performance programs in intelligence. As reported in the press, CIA Director George

⁴⁴ The OPM Status Report sets forth that the DNI launched a planning phase in September 2006, which produced a Detailed Design and Implementation Plan. OPM Study at 22.

⁴⁵ OPM Study at 22.

Tenet had developed such a poor program that when his successor, Porter Goss, came in, “Goss canceled a pay-for-performance program that was almost universally disliked by employees.”⁴⁶

The Administration may tell this Subcommittee that the IC involves so much classified information that oversight cannot occur – although it would be strange for OPM to write extensively and glowingly in its (unclassified) Status Report about the “pay modernization” project and then to stonewall oversight. In any event, the claim that this Subcommittee cannot perform oversight because of intelligence agency sensitivities is simply not true. In 1996, GAO did a study for Rep. Patricia Schroeder: *Intelligence Agencies: Personnel Practices at CIA, NSA, and DIA Compared With Those of Other Agencies*.⁴⁷ The study reviewed adverse agency actions. “GAO found that very few adverse action cases involve sensitive information. Specifically, in recent NSA and DIA adverse actions reviewed by GAO, 39 of 40 cases files (or 98 percent) contained no classified national security information.”⁴⁸ I note that the 1996 study include extensive work on EEO cases, and percentages of minorities and women, in the 3 intelligence agencies. The 68 page GAO study was unclassified. It reflects careful attention to CIA requests to modify or delete text to make it so.⁴⁹

Congress must check the Administration’s potential to repeat the NSPS’s failing, and make sure that if the Administration believes in pay-for-performance enough to go ahead with it, the Administration budgets enough truly new funding for the pay increases, even if that has to come out of those contractor projects.

Transportation Safety Administration – the PASS System

The Transportation Safety Administration (TSA) launched, in 2006, a pay-for-performance program called the Performance Accountability and Standards System (PASS). A 2007 GAO report on airport security found TSA had a high attrition rate, with a deleterious effect on security. It attributed the high attrition rate, among other factors, to TSA’s personnel system.⁵⁰ Union testimony last July further elaborated on the dismal state of TSA morale under PASS.⁵¹

Conclusions

To summarize, I suggest further lines of inquiry.

1. A Proposal for Reducing the Mystery and Nontransparency

There is every reason not to go ahead with NSPS and other pay-for-performance systems, unless the Administration reduces the deliberate mystery and nontransparency surrounding it. I suggest an authorization provision, either in bill text or in report language, that conditions the inclusion of any unit in NSPS (and other systems) with the availability of aggregate figures, and an opportunity of follow-up, for an employee

⁴⁶ Faye Bowers, *Behind CIA’s Personnel Changes*, Christian Science Monitor, Nov. 17, 2004, at 2.

⁴⁷ GAO/NSIAD-96-6

⁴⁸ *Id.* at 5.

⁴⁹ *Id.* at 53.

⁵⁰ GAO-07-299

⁵¹ “[PASS] was unveiled in 2006 and is already in disarray. TSA’s PASS system is one of the largest concerns for TSA employees... Allegations of favoritism and cronyism surround the system. . . .” Testimony of Colleen Kelley, National President, National Treasury Employee Union, *Hearing Before the Federal Workforce Subcommittee of House Oversight and Government Reform*, July 31, 2007, at 11.

organization seeking to bargain, to petition other authorities, or to file a grievance, regarding arbitrariness in the implementation of the pay-for-performance system.

The aggregation would break down the department- or agency-wide figures along divisional and/or regional (or other geographic) lines – a breakdown to the organizational unit level making discussions feasible roughly along something like union local lines. Thus, a union local would be able to tell, from the aggregate breakdown for a unit's members, their distribution of evaluation numbers; how that distribution had been translated or normalized into shares of the relevant pay pool; how funds had gone into that pay pool; and what individual raises had emerged. The opportunity for follow-up would include, upon request by the union local(s) for that unit, an opportunity to review individual evaluations (perhaps subject to an opt-out provision)⁵² to determine the validity and fairness of the evaluation and raise-distribution methods. This would greatly increase the transparency of the system, de-mystify it, and correct its arbitrariness and unfairness.

Also, as previously described, the GAO's Strategic Issues office should be commissioned to study minority (including age) statistics as to pay-for-performance on a multi-agency, cross-cutting basis.

It is possible that the two approaches could be combined, by having either the GAO, or the agency, break down the minority (and age) statistics as to pay for performance on a unit level. This would facilitate rooting out those units, like the SEC, in which the statistics indicate a agency-wide prima facie discrimination situation, leading either directly to corrective action, or to a grievance or other trial for a ruling about discrimination.

2. Freezing or Rolling-Back Pay for Performance

Whether on an agency-wide basis, or more selectively, the problems described above may warrant either freezing the pay-for-performance system as it is (without further roll-outs), or even returning some units or agencies to GS. I am a firm believer in the necessity of transparency and checks on hidden arbitrariness, especially when there is also a background of systemic discrimination risks, along the lines scribed above. Accordingly, I would recommend either or both of the following: (1) that a freeze or roll-back apply to agencies or units that fail to achieve this transparency by a deadline; and/or, (2) that a freeze or roll-back apply to agencies or units for which transparency reveals either arbitrariness or a prima facie situation of discrimination.

⁵² Perhaps an individual employee could opt-out by asking that their particular evaluation not be made available for such analysis. But, the experience of the SEC arbitration that found age and race discrimination based on statistical evidence pulled together by an employee union shows there is no substitute for allowing meaningful union scrutiny.

Mr. DAVIS OF ILLINOIS. We will go to the Honorable J. Russell George.

STATEMENT OF J. RUSSELL GEORGE

Mr. GEORGE. Thank you, Mr. Chairman, Delegate Norton. It's a pleasure to be before you today to discuss the Internal Revenue Service's pay-for-performance system.

The Federal Government is faced with a human capital crisis, and the IRS is no exception. By the end of fiscal 2010, 66 percent of the IRS's executives, 50 percent of its senior managers and 36 percent of its front-line managers will be eligible to retire.

To its credit, the IRS has already begun efforts to address its human capital challenges. It has made progress in transforming the agency into a more efficient, modern and responsive organization.

A tool that should help recruit, retain and motivate managers is a pay-for-performance system, but to do so, it needs a good design and an even better implementation.

TIGTA has looked closely at the IRS pay-for-performance system. If I were to issue a grade on the system similar to the report cards that former Representative Steve Horn issued when he was a subcommittee chairman on this committee, I would have to give the IRS a C.

The IRS' efforts to implement a pay-for-performance system began after enactment of the IRS Restructuring and Reform Act of 1998. The IRS has implemented its pay-for-performance system in three phases. Phase 1 for senior managers was launched in March 2001. It placed all grades 14 or 15 mid level managers into one pay band. Phase 2 for department managers was launched in November 2001. It placed all grades 11 to 13 second-level managers at IRS campuses into one pay band. Phase 3, which was launched in 2005, placed all front-line managers from grade 5 to 15 into 11 pay bands.

TIGTA's July 2007 audit of the pay-for-performance system found three major shortcomings in its design. First, the IRS's pay-for-performance structure did not provide the benefits envisioned in the Reform Act. These benefits include the flexibility to assign new or different work, a greater ability to hire more quickly and offer more competitive salaries, and the ability to provide employees with better opportunities to enhance their knowledge and advance their careers.

Second, the method for determining annual salary increases for managers on all three pay systems may result in pay inequities. For example, managers could receive increases that are less than those received by other nonmanagerial employees who automatically receive the annual across-the-board salary increases established by the President.

Third, the Office of Personnel Management requires that the lowest and highest salaries for each pay band must be commensurate with the corresponding GS pay system's salary changes. As a result, managers at either end of a pay band would automatically receive annual across-the-board salary increases regardless of their performance rating. However, managers whose salary fall in the middle of the pay bands are rewarded based on their performance.

Regarding implementation, TIGTA found that the IRS did not allow sufficient time to educate managers on the details of the front-line manager system. This resulted in increased opposition and decreased morale among the 6,600 front-line managers. Unfortunately, this lack of communication occurred because the IRS accelerated implementation of the system by at least a year in order to minimize the conversion costs in fiscal year 2005. This acceleration left little time to explain the system and no time at all to receive feedback prior to its implementation. Predictably this caused significant frustration.

The IRS responded to TIGTA's finding by initiating a third-party evaluation to be conducted in three phases over 5 years. This lengthy timeframe is of concern. We are monitoring the IRS' corrective actions and will conduct a followup review. In addition, the IRS plans to continue partnering with the management associations representing a number of IRS managers on pay-for-performance issues. The IRS has also agreed to communicate more effectively with employees before, during and after any additional changes to the system.

However, the IRS disagreed with our recommendation to reinstate its policy of providing across-the-board adjustments to managers who receive a satisfactory or higher performance rating. The IRS stated that the authority for determining salary increases rests with the IRS Commissioner. The Commissioner does, indeed, have the authority to set pay increases, and I would not suggest that this authority be removed; however, the Commissioner can reinstate the policy of providing across-the-board adjustments and still give higher pay raises to highly rated managers. The Commissioner could allocate amounts that have previously been designated for within-grade step increases and quality step increases to recognize higher-rated managers.

The difficulty of designing and implementing a pay-for-performance system in an agency as large and complex as the IRS cannot be overstated. TIGTA is dedicated to helping the IRS navigate through this difficult project, as well as the many other human capital challenges that it faces.

Thank you, Mr. Chairman.

Mr. DAVIS OF ILLINOIS. Thank you very much.

[The prepared statement of Mr. George follows:]

**HEARING BEFORE THE SUBCOMMITTEE ON
FEDERAL WORKFORCE, POSTAL SERVICE AND THE
DISTRICT OF COLUMBIA
COMMITTEE ON OVERSIGHT AND
GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES**



FEBRUARY 12, 2008

Washington, DC

**The Honorable J. Russell George
Treasury Inspector General for Tax Administration**

STATEMENT OF
THE HONORABLE J. RUSSELL GEORGE
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
before the
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE AND
THE DISTRICT OF COLUMBIA
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

February 12, 2008

Chairman Davis, Ranking Member Marchant, and Members of the Subcommittee, thank you for the opportunity to appear before you today to testify on the Internal Revenue Service's (IRS) pay-for-performance system. Human capital issues are increasingly becoming a serious organizational matter, and none are more far-reaching than the issue of an employee's pay. While many Federal agencies have sought to implement some form of pay for performance, time after time the transition has been met with considerable resistance. The IRS is no exception.

In 2007, the Treasury Inspector General for Tax Administration (TIGTA) conducted a review of the IRS's pay-for-performance system.¹ We concluded that the IRS needed to improve both the design and implementation of the system. The current system may not support the IRS's initiatives to recruit, retain, and motivate future leaders. On the contrary, it may discourage managers from seeking promotions and non-managers from applying for manager positions. We identified several reasons for this, which I will discuss later in my testimony.

The IRS's efforts to implement a pay-for-performance system began with the enactment of the IRS Restructuring and Reform Act of 1998² (RRA 98). The RRA 98 gave the IRS the ability to establish one or more pay-for-performance systems to assist in restructuring the agency. In December 2000, pursuant to the RRA 98 directive, the Office of Personnel Management (OPM) provided guidance to the IRS in designing such a pay system.

The IRS implemented its pay-for-performance system in three phases, encompassing all of the agency's managers:

¹ *The Internal Revenue Pay-for-Performance System May Not Support Initiatives to Recruit, Retain, and Motivate Future Leaders* (Reference Number 2007-10-106, dated July 3, 2007).

² Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

- The first phase for “Senior Managers” grouped former General Service (GS) grade 14 and 15 mid-level managers and direct reports to executives into one pay band. This phase became effective in March 2001.
- The second phase for “Department Managers” grouped former GS-11 to GS-13 second-level managers³ in campuses⁴ into one pay band. It became effective in November 2001.
- The third phase for “Frontline Managers” maintained the existing 11 pay bands for the former GS-5 to GS-15 Frontline Managers⁵ and became effective in September 2005.

Changing to a new pay-for-performance system could not have come at a more critical time for the IRS. According to the IRS, about 66 percent of executives, 50 percent of Senior Managers, 29 percent of Department Managers, and 36 percent of Frontline Managers will be eligible to retire by the end of 2010.⁶ In this environment, it is even more important to ensure that managers are satisfied with their jobs and that employees view manager positions favorably. The IRS’s ability to meet program requirements and the expectations of external and internal customers depends largely on recruiting and maintaining a highly skilled and motivated workforce.

TIGTA identified several areas in the IRS’s pay-for-performance system that needed improvement, involving both the design and implementation of the system.

Design shortcomings

Among our findings, TIGTA identified three major design shortcomings in the IRS pay-for-performance system.

The first involved how the IRS structured the Frontline Manager system. The IRS did not use the RRA 98 flexibilities to improve the existing classification system (General Schedule) in the Frontline Manager system as it had in the Senior Manager and Department Manager systems. Instead, the frontline manager system reflected the existing grade structure for Frontline Managers. There were two contributing factors for this design flaw.

The Human Capital Officer concluded that there were advantages of grouping these GS grades into broad pay bands, but the existing structure had a wide variety of occupations and grades that the IRS indicated were difficult to group. After several attempts, IRS senior management failed to reach an organizational consensus on how to

³ Second-level managers supervise one or more frontline managers.

⁴ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

⁵ Frontline managers supervise one or more staff (non-managerial) employees.

⁶ Human Capital Office internal communication message, dated March 9, 2007.

combine the structure.⁷ As a result, the IRS simply brought frontline managers over to the new pay system at their existing grade level, renaming them “pay bands.”

In addition, the IRS accelerated its implementation for the frontline manager system by at least a year. Initial plans were to implement it at the beginning of Fiscal Year 2007.⁸ However, the IRS decided to implement the Frontline Manager system at the end of Fiscal Year 2005 to minimize the cost of converting the frontline managers to the pay-for-performance system.⁹

The IRS’s pay-for-performance structure also did not provide the IRS with the benefits envisioned in the RRA 98, including: 1) the flexibility to assign new or different work; 2) a greater ability to hire more quickly and offer competitive salaries; and 3) providing employees with better opportunities to diversify their knowledge and advance their careers.

The second major design shortcoming involved how annual salary increases for managers were determined. Managers in all three pay systems may receive less than the annual across-the-board salary increase established by the President and given to all employees under the GS pay system. This is a concern to many managers because the across-the-board increase is not tied to performance ratings; instead, it addresses the rising cost of labor based on the Employment Cost Index. Under the RRA 98, the IRS Commissioner has the flexibility to determine the managers’ annual salary increases. Therefore, if the Commissioner decides to provide a larger salary increase to managers with higher annual evaluations (e.g., Exceeded Expectations or Outstanding) and a smaller increase to managers with satisfactory evaluations (e.g., Met Expectations), it could result in some managers receiving less than the annual across-the-board salary increase. This could put some managers at a pay disadvantage compared to the approximately 90,000 IRS non-managerial employees who remain in comparable GS pay system grades and will continue to receive the annual across-the-board salary increase.

The third major design shortcoming involved a requirement by the OPM that the lowest and highest salaries for each pay band would be commensurate with the corresponding GS pay system salary ranges and would automatically increase in line with

⁷ IRS management advised us during the audit that there were several senior management meetings addressing the frontline manager structure, but they were unable to reach consensus on a different structure for the pay-for-performance system for frontline managers.

⁸ IRS management advised us during the audit that the frontline manager system was included as a budget initiative in an earlier version of the Fiscal Year 2007 budget request but was subsequently removed and implemented in the last pay period of Fiscal Year 2005 to save costs.

⁹ IRS Policy Number 85, effective in September 2005, stated that, at conversion, managers eligible for a within-grade increase would receive an increase in base pay equal to the prorated value of the manager’s time spent toward his or her next GS step increase. Under pay-for-performance, managers would no longer be eligible for step increases or quality step increases.

any across-the-board salary increases.¹⁰ However, this requirement may lead to inequitable salary increases for managers within the same pay band. For example, a manager at either end of a pay band, regardless of their performance ratings, will receive the equivalent of the across-the-board salary increase. Alternatively, a manager in the middle of a pay band who received an Outstanding rating could receive much more than the across-the-board increase, as long as the increase is within the new salary range of the pay band.

Implementation shortcomings

TIGTA found that the IRS did not plan for sufficient time to educate managers on the details of the frontline manager pay system, which resulted in increased opposition and decreased morale for some Frontline Managers. At the time of our review, the frontline manager pay system affected 77 percent of all IRS managers.¹¹ The IRS needed to provide Frontline Managers with an opportunity to surface questions and concerns about the new pay system to ensure these managers clearly understood the new process for determining salary increases under the pay-for-performance system. This emphasis on communication was especially important because the IRS eliminated its prior policy of providing managers in the pay-for-performance system with the equivalent of the across-the-board annual salary increase. This policy change was effective for managers in all three pay systems.¹² In addition, because the Frontline manager system was implemented at the end of Fiscal Year 2005 and the IRS Deputy Commissioner did not advise managers how much their annual salary increase would be until the beginning of Fiscal Year 2007,¹³ managers were left wondering during the entire 2006 rating period what their potential salary increase would be. Predictably, there was significant frustration about the lack of communication on how managers' pay would be affected and how the new pay structure was decided.

IRS Response

In response to our findings, the IRS initiated a third-party evaluation¹⁴ of the IRS's pay-for-performance system. This ongoing evaluation is being conducted in three phases over five years and will determine whether, and how strongly, the IRS's current

¹⁰ As an example, the GS-09 base salary effective January 2007 ranged from \$38,824 (Step 1) to \$50,470 (Step 10). The pay-for-performance pay band 9 would also have a salary range of \$38,824 to \$50,470, although there are no steps. In January 2008, the GS-09 base salary increased to \$39,795 for Step 1 and \$51,738 for Step 10. Accordingly, the pay-for-performance pay band 9 would increase by the same amount to maintain the same salary range.

¹¹ IRS Workforce report as of June 24, 2006.

¹² IRS presentation in August 2005 explaining the implementation of the frontline manager system in September 2005 and revisions to the senior manager and department manager systems planned for January 2006. The first performance based salary increases would occur in January 2007 for all three systems, and would replace the annual across-the-board salary increase under the GS pay system.

¹³ Deputy Commissioner for Operations Support memorandum to all IRS managers, dated October 5, 2006.

¹⁴ In the IRS response to the Draft report, the IRS stated it had initiated a third party evaluation of its pay-for-performance system. A September 25, 2007 news article in Government Executive states "The IRS has hired an outside consultantto determine whether it [the system] is helping to recruit, motivate and keep talented employees..... The company also will provide recommendations to strengthen the system."

pay-for-performance system supports its organizational goals to recruit, retain, and motivate future leaders. We are concerned with the length of time the IRS is planning to take to further evaluate its pay-for-performance system. We plan to monitor the IRS's corrective actions and will conduct a follow-up review.

The IRS plans to continue to partner with the management associations¹⁵ representing a number of IRS managers on pay-for-performance issues. The IRS also plans to work with IRS operating divisions and functional stakeholders¹⁶ to determine the best means to communicate information on pay-for-performance updates. Further, the IRS agreed to more effectively communicate with employees before, during, and after implementing any new changes to the IRS's pay-for-performance system.

However, the IRS disagreed with our recommendation to reinstate the policy of providing annual across-the-board adjustments for managers who receive a Satisfactory (Met Expectations) or higher performance rating. The IRS stated that the authority for determining salary increases rests with the IRS Commissioner and that future commissioners need this flexibility to set their own policy. The IRS further stated that this recommendation was not fiscally practicable due to budget implications and constraints.

I recognize that the Commissioner has the authority to set pay increases and am not suggesting that this authority be removed. I also recognize the Commissioner's desire to grant pay raises with meaningful distinctions for highly rated managers. However, I believe that the Commissioner can do both without decreasing the morale of managers who met their performance expectations. The Commissioner could allocate amounts that would have been previously given for within-grade step increases and quality step increases to the higher-rated managers.

IRS Critical Pay Authority

Another personnel flexibility granted to the IRS as part of the RRA 98 was the ability to establish critical pay positions¹⁷ at the IRS, with approval from the Office of Management and Budget. The RRA 98 also gave the IRS streamlined critical pay¹⁸ authority for up to 40 positions for a 10-year period (expiring on July 22, 2008). These streamlined positions were limited to a term of four years and required approval by the Secretary of the Treasury but not from the Office of Management and Budget. These two

¹⁵ The Federal Managers Association and the Professional Managers Association.

¹⁶ Operating division stakeholders include the Large and Mid-Size Business Division, Small Business/Self-Employed Division, Tax Exempt and Government Entities Division, and Wage and Investment Division. Functional stakeholders include various other offices within the IRS, such as those reporting directly to the Commissioner, Deputy Commissioner for Operations Support, or Deputy Commissioner for Services and Enforcement.

¹⁷ For these positions, compensation may be set at a higher rate than the pay of most Federal Government executives, but may not exceed the Vice President's salary (\$221,000 for Calendar Year 2008).

¹⁸ During the audit period, several of the IRS Operation Division Commissioners, the Chief Information Officer as well as the Chief Agency-Wide Shared Services were designated as streamlined critical pay employees.

critical pay personnel flexibilities were intended to provide the Commissioner with the ability to bring in experts and the flexibility to revitalize the current IRS workforce.

In Fiscal Year 2003, we reviewed¹⁹ the IRS's use of streamlined critical pay authority to determine whether the IRS conformed to established laws and regulations, and to analyze the costs associated with the program. We reviewed the salaries for 48 critical pay hires and determined that, in all instances, the salaries plus performance bonuses were computed according to guidelines and did not exceed the salary of the Vice President. As of September 2002, the IRS had incurred costs of approximately \$8 million associated with the critical pay authority, including base salary increases, search firm costs, bonuses, and relocation costs. In some cases, the IRS initially designated positions as critical pay positions but subsequently filled them as Senior Executive Service positions. This was done because either qualified outside candidates could not be found or declined the positions, or IRS officials identified an internal candidate who was more highly qualified. The IRS and the IRS Oversight Board agreed to expand the Board's oversight of the critical pay authority by having the Board conduct an annual program review of the authority as a whole.

We recommended that the IRS obtain the Oversight Board's approval for all critical pay positions. The IRS disagreed with this recommendation, saying that it could reduce the intended benefits of the streamlined authority and that the Board's annual assessment should be adequate to determine whether this authority had been used appropriately. However, because the designation of certain positions as streamlined critical indicates a high level of importance to the success of the IRS mission, we believe that the IRS Oversight Board should be a part of the approval process for all streamlined critical pay positions.

TIGTA's Audit Strategy on Human Capital Issues

While pay-for-performance is an important part of the human capital challenge facing many agencies, it is only one aspect. Within the IRS, the term "human capital" represents the philosophy that the linkage of critical human capital assets to business strategies ultimately leads to organizational success.²⁰ IRS employees are recognized as critical to the attainment of the IRS vision.

Like many other Federal agencies, the IRS has experienced workforce challenges over the past few years. Those challenges include recruiting, training and retraining employees, as well as an increasing number of employees who are eligible to retire. While the IRS has made some progress, the strategic management of human capital remains one of the IRS's major management challenge areas. As a result, TIGTA has developed a cross-cutting audit strategy for Fiscal Year 2008 and beyond that addresses the broader human capital challenge across the IRS.

¹⁹ *Oversight of Streamlined Critical Pay Authority Could Be Improved* (Reference Number 2003-10-116, dated June 2003).

²⁰ IRS Human Capital Office, *Concept of Operations* (April 2005).

Our audit strategy will align our work with the Human Capital Assessment and Accountability Framework created by the OPM and the Government Accountability Office. This framework consists of five human capital processes that together provide a consistent, comprehensive representation of human capital management for the Federal Government. The framework includes: strategic alignment; leadership and knowledge management; results-oriented performance culture; talent management; and accountability.

Currently, we have ongoing audits in the areas of IRS succession planning activities, retirement and separation estimates, employee skill gaps in key mission-critical occupations, the Workers Compensation Program, and use of sick leave under the Federal Employees Retirement System. We are planning another audit later this year on recruiting strategies.

I hope my discussion of this very important issue will assist the Subcommittee with its consideration of pay-for-performance systems within the Federal Government. Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to provide TIGTA's evaluation of this human capital pay structure. I would be pleased to answer any questions you may have at the appropriate time.

Mr. DAVIS OF ILLINOIS. And we will go to Dr. Charles Fay.

STATEMENT OF CHARLES FAY

Mr. FAY. Thank you, Chairman Davis and Delegate Norton.

Let me start out by saying that my whole background leads me to be in favor of pay for performance and performance management. Those two things, in conjunction together, have been shown in many cases in the private sector to work very well.

When I look at the public-sector case, and the systems of the SEC, the IRS and even the DOD, I am deeply disappointed. Those systems don't work. I don't think they are likely to work. They seem to me to violate many of the requirements for a good pay-for-performance system that my coauthor and I set out in the publication that was submitted as part of my testimony that was sponsored by the IBM Center for the Business of Government.

Let me do a couple of things; first, separate the notion of performance management and compensation, or pay for performance. Performance management is the key point. If people get that right, then the pay for performance becomes much easier, and it is clear in these systems that they have not gotten the performance management part right, not at all. In addition, as several people have noted, the SEC also messed up seriously on the pay-for-performance part of it. So they struck out in both cases.

Let me just tell you some of the things that I see in this that violate the basic principles of a pay-for-performance system and a merit-pay system. The first of those is that performance criteria need to be job-specific. That's performance management 101. When you have criteria for someone's performance, those have to be specific to that job.

Second, the general competencies and criteria that have been used by at least two of the systems that I have seen, DOD and IRS, who have published portions of them, are very general and very subject to bias, as a couple of people have mentioned. This is just asking for trouble when you ask managers to make decisions based on these kinds of things.

Third, and perhaps most important from my perspective, it's critical that raters and the people who are rated be trained in how to do performance management from both sides of the aisle. Both the management and the director need to be able to know how to work this system, know how to use it correctly and to have some understanding for the reason for the system. In the documentation I see, there does not appear to be any, or at least not much, training of people.

Third, the instructions should be written in plain English. The IRS reminds me of tax forms that I tried to fill out every year, and the DOD, pure "mil spec." I have a Ph.D. I consider myself to be fairly reasonably cognizant of the English language, and I had a hard time figuring out what you are really supposed to do with some of these languages.

Finally, I would like to stress that all of these systems are subjective by their nature. No performance management system or performance appraisal system is not subjective. They cannot be objective. If anyone has issues with that, think about the last time

you had overhead allocated to a program that's highly objective. But it's very subjective how those dollars get allocated.

So, again, I still believe people should manage performance. I believe the government should investigate performance management, should work at pay for performance, but I think they need to do a much better job than has been done so far.

Thank you.

Mr. DAVIS OF ILLINOIS. Thank you very much.

We will go to Mr. Tobias.

STATEMENT OF ROBERT TOBIAS

Mr. TOBIAS. Thank you very much, Mr. Chairman.

As Inspector General George pointed out, the Internal Revenue Service got the authority to create pay-for-performance systems, and what I did was take a look at some employee surveys of the senior managers, the departmental managers that were conducted to determine whether or not the IRS achieved its goals.

I think the results of these surveys reveal very clearly that the IRS has not achieved its goals of creating a pay-for-performance system that links individual and organizational goals with compensation, or that supports better rewards for better performance. For example, only one in four senior managers agree that the pay-for-performance system is a fair system for evaluating or rewarding job performance; 58 percent of the managers stated that the pay-for-performance system had no impact, no impact on their motivation to increase performance; and 18 percent stated it had a negative impact.

Less than 20 percent of the senior managers agreed that the pay-for-performance system is linked to organizational results or has improved business unit or IRS performance. Only 17 percent stated that their performance was linked to their pay, and only 16 percent stated that their performance was linked to strategic business goals; 46 percent state that had they preferred the GS system.

Now, I think there are several reasons why the IRS goals have not been achieved. First, the data does not reveal that employees are motivated by pay; rather, I believe Federal employees are motivated to increase their performance far more by effective leadership and an effective performance management system.

Second, I think it's difficult, if not impossible, to have a successful pay-for-performance system if the leadership and the agency does not support it. In a 2006 survey of the Senior Executive Service, the persons who must be counted on to implement a pay-for-performance system, reveal that they are extremely unhappy with their pay-for-performance system; 83 percent stated it had no impact on their performance, and 33 percent indicated it had a negative impact on morale; 54 percent indicated their pay-for-performance system had no impact on their motivation to increase performance, and 8 percent indicated it had a negative impact; 44 percent felt their ratings were fair and accurate, but 33 percent disagree, and 23 percent did not know.

Since the organizational change necessary to support the introduction of a pay-for-performance system is not enthusiastically endorsed by senior career leaders, it's no surprise that those they lead do not endorse it.

Third, trust is a critical component necessary to implement any significant organizational change effort, and particularly pay for performance. Only 50 percent of the close to one-quarter of a million Federal employee respondents to the Federal Human Capital Survey answered “strongly agree” or “agree” to the statement, “My organization’s leaders maintain high standards of honesty and integrity;” 20 percent reported either “strongly disagree” or “disagree.”

In the IRS work force, only 43 percent “strongly agree” or “agree” with the statement, and 23 percent “strongly disagree” or “disagree.”

The IRS has even more work to do if it wants to successfully implement a pay-for-performance system.

Now, can the IRS achieve its stated goals in the future? I think—because the data shows that Federal employees are not necessarily motivated to increase their performance solely because of monetary rewards, I believe it’s highly questionable that the IRS can successfully implement a pay-for-performance system.

Because Federal employees are motivated to increase their performance when they are effectively led and their skills are matched to their mission, I believe it is possible to increase individual and organizational performance results with the design, development and implementation of a performance management system.

Now, I believe Presidents, political appointees, members of the Senior Executive Service, midlevel managers, union leaders and employees all want increased performance. That’s why they are part of public service. Harnessing that energy to actually improve performance in the executive branch requires the collaborative involvement of all parties. I believe it can be done, but I don’t see any real evidence of a focus on improving performance management.

Thank you very much, Mr. Chairman.

Mr. DAVIS OF ILLINOIS. Thank you. Thank you very much.

[The prepared statement of Mr. Tobias follows:]

**Testimony of
Robert M. Tobias, Director
Public Sector Executive Education
American University**

Before The

**House Subcommittee on
Federal Workforce, Postal Service and the District
of Columbia**

On

Personnel Reform in the Federal Government

February 12, 2008

Today's hearing examines the implementation and effect on personnel of pay for performance systems, at the Security and Exchange Commission, Internal Revenue Service, and Government Accountability Office. I will focus my attention on the Internal Revenue Service.

Congress gave the Internal Revenue Service the authority to create a pay for performance system for all its employees in the Internal Revenue Service Revenue and Reform Act of 1998. The IRS implemented a pay for performance system for senior (SM) and second level or departmental (DM) managers in March 2001. All other managers were brought into the system in September 2005. The IRS has made no effort to place bargaining unit employees in a pay for performance system.

The goals of the IRS system are simply stated:

1. Create a compensation system that supports better rewards for better performance
2. Create a link between organizational and individual goals and compensation based on individual achievement
3. Create a compensation system that is more flexible than the GS classification and pay system.

To determine whether the goals are being achieved, the IRS conducted employee surveys of Senior Managers and Managers of Senior Managers in 2003, and 2004 and Departmental Managers in 2003.

The results of both surveys reveal a system that has not achieved its stated goals:

A. Results of IRS Senior Manager Survey

1. Only one in four SMs agree that the pay for performance system is a fair system for evaluating or rewarding job performance. The managers of the senior managers, those responsible for implementing the system, hold the same view.
2. Fifty eight percent of the SMs stated the pay for performance system had no impact on their motivation to increase performance, and 18% stated it had a negative impact.
3. Sixty five percent of the SMs stated that the system had no impact on their motivation to apply for jobs with greater responsibility.
4. Only 35 percent of the managers of senior managers saw a link between senior managers' performance bonus amounts and their job performance.
5. Less than 20 percent of senior managers agreed that the pay for performance system is linked to organizational results or has improved business unit or IRS performance; 13 percent agreed that the system improved business unit performance; and 12 percent agreed that overall results were increased.
6. Only 17 percent stated their performance was linked to their pay, and only 16 percent stated it was linked to strategic business goals.
7. Three out of four do not believe the system will help them move to an SES job.
8. Forty six percent stated they preferred the GS system.

B. Results of IRS Departmental Manager Survey

1. Fifty six percent stated the new system had no impact on their motivation to increase their performance and 10 percent stated it had a negative impact.
2. Fifty four percent stated they system had no impact on their motivation to apply for a job with increased responsibility.

3. Only 12 percent “strongly agreed” or “agreed” that the system improved performance in the IRS
4. Only 28 percent stated they saw a link between their performance goals and IRS organization goals.
5. Twenty eight percent indicated that the link between their job performance and pay decreased and 31 percent stated it stayed the same with the introduction of the pay for performance system.
6. Only 24 percent felt their ratings were fair.
7. Sixty nine percent stated it was neither more nor less likely they would stay with the IRS based on the pay for performance system.
8. Forty seven percent favored the GS system while 27 percent favored the pay for performance system.

The “better rewards for better performance” goal has not been achieved because so many employees see the system as unfair. Similarly, the data reveals employees do not believe a link exists between individual and organizational performance and rewards. More importantly, the system does not provide motivation for improved performance, an assumption that is a bedrock rationale for a pay for performance system.

C. Why has the IRS been unable to achieve its stated goals?

- 1. The fundamental assumption of a pay for performance system that rewarding high performance with higher pay motivates employees to even higher levels of performance, may not apply in the federal sector.**

A recent article by James Perry, Debra Mesch, and Laurie Paarlberg reviewed approximately 2,600 research studies concerning which factors motivate employees in the public and private sector to increase their performance (Perry 2006). Research found that in a private sector organization, financial incentives to improve task performance were moderately to significantly successful. However, “individual financial incentives are ineffective in traditional public sector

settings” (Perry 2006, 507). The authors speculate that the failure “is likely due to a lack of adequate funding for merit pay and an absence of the organizational and managerial characteristics that are necessary to make pay for performance work in traditional government settings” (Perry 2006, 507).

This finding is supported by my work as the Director of American University’s Institute for the Study of Public Policy Implementation and as a collaborator with the Partnership for Public Service. We found that the two most critical factors necessary to increase employee engagement are increasing leadership capacity and matching employee skills to agency mission.

Similarly, the Corporate Executive Board surveyed 50,000 employees in 59 organizations world wide and found that employees with lower engagement are four times more likely to leave their jobs than those who are highly engaged. Even more importantly, a highly engaged workforce can result in a 21 percent increase in productive performance.

The Corporate Executive Board, like the Best Places to Work analysis, found that the most important driver of engagement is a connection between an employee’s success and the organization’s success

2. A 2006 survey of the Senior Executive Service, the persons who must be counted on to implement a pay for performance system, revealed they are extremely unhappy with their own pay for performance system.

- A. Eighty three percent stated it had no impact on their performance, and thirty three percent indicated it had a negative impact on morale.
- B. Fifty four percent indicated their pay for performance system had no impact on their motivation to increase performance and eight percent indicated it had a negative impact.

- C. Forty four percent felt their ratings were fair and accurate, but 33 percent disagree, and 23 percent did not know.
- D. The “don’t know” answer is based on the fact that 72 percent of the respondents indicated their agency failed to share rating information.

Since the organizational change necessary to support the introduction of a pay for performance system is not enthusiastically endorsed by senior career leaders, it is no surprise that those they lead do not endorse it.

The latest OPM report concerning performance based pay in the federal government (OPM 2007) does not contain any data to refute the survey results from IRS managers or members of the Senior Executive Service.

3. A critical component to successfully implementing any significant organizational change effort, and particularly with pay for performance, is trust. And trust is not present.

The question is whether those who must change, trust those who seek change? Based on the Office of Human Capital's Federal Human Capital Survey, the answer is many do not.

Only fifty percent of the close to one quarter of a million federal employee respondents to the Federal Human Capital Survey answered “strongly agree” or “agree” to the statement, “My organization's leaders maintain high standards of honesty and integrity.” Twenty percent reported either “strongly disagree” or “disagree.”

With twenty percent of the workforce or 380,000 employees lacking trust in their leaders, it will be difficult, if not impossible, to successfully implement a pay for performance system.

In the IRS workforce only forty three percent “strongly agree” or “agree” with the statement, and twenty three percent “strongly disagree” or “disagree.” The IRS has even more work to do if it wants to successfully implement a pay for performance system.

4. The IRS pay for performance system was implemented before a credible, transparent performance management system was created.

The essence of a performance management system is the creation of strategic organizational goals and defining individual goals that link individual performance to organizational goals. The process for the creation of a performance management system is extremely difficult, and includes the following steps:

- A. Defining organizational output and outcome goals,
- B. Creating a plan for translating the goals by supervisors into individual goals linked to organizational goals,
- C. Ensuring that supervisors spend time talking and listening to those they manage, coaching, evaluating performance, and monitoring organizational goal achievement, and
- D. Successfully implementing the system.

The IRS Survey data reveals the steps in creating a performance management system were not successfully concluded. Without agreement about individual and organizational goals, we see results like those in the IRS survey: complaints about lack of fairness because goals are unclear and comparisons perceived as arbitrary, and a lack of linkage between individual and organizational goals. A pay for performance system is guaranteed to fail if it not bolted onto a transparent, credible performance management system.

There is little question that effective goal setting does increase performance. The Perry research also found it is virtually undisputed that goal setting does increase performance at all levels: individual, group, and organization. As Perry points out, . . . [S]pecific and challenging goals are associated with higher levels of

performance, more so than either no goals or general 'do your best goals'" (Perry 2006, 509).

It should be noted that goal setting in the public sector is more difficult than in the private sector (Perry 2006). Output and outcome goals are difficult to define credibly to those who seek to achieve them, to those managing the effort, and to those benefiting from the goal achievement.

Yet, if successful, goal setting increases employee engagement, individual and organizational performance, and taxpayer satisfaction. Thus, it is an outcome worthy of pursuit.

The challenge of goal setting is to craft individual and organizational outcome goals that are both consistent with agency mission and set at a level that drives innovation.

Since the 1993 the passage of the Government and Performance and Results Act (GPRA), agencies have been struggling to identify outcome rather than output or "working hard" goals. There has been a great deal of well chronicled difficulty and resistance in Government Accountability Reports.

Agencies and agency leaders find it difficult to reduce their mission achievement or outcome to clear and measurable standards. To complicate matters, President Bush created the Program Assessment Rating Tool (PART) to evaluate more than 1,000 programs across the federal government. Both GPRA and PART Program Managers have had a great deal of difficulty defining measurable program outcomes.

Assuming an agency is willing and able to set organizational outcome goals, the next step is for supervisors to link individual performance plans to agency goals: Once again, no easy task.

Managers must then communicate the individual goals to employees, and provide them with regular feedback on progress, coaching and development opportunities, and an evaluation based on results.

It is very easy to write a policy to achieve these goals; however, it is extremely difficult for 1.9 million federal supervisors and employees to redefine their relationship with each other in order to implement the policy.

Currently, supervisors generally evaluate an employee's performance on whether the employee "works hard." If an employee "works hard," he/she is likely to be rated highly. Under a performance management system, the standard would be "achieves results." This would entail a change from a subjective evaluation of performance to a significantly increased focus on the achievement of objective performance results.

Long term supervisor/employee relationships have been built on one set of expectations. Those relationships would have to evolve to accommodate another set of expectations. Supervisors will have to be trained to expect "results" and evaluate employees' work accordingly, and employees will want and expect support.

Achieving the desired change is further complicated by the fact that many supervisors spend the majority of their time "doing" rather than leading. This leaves little time or energy for employee performance discussions, development and coaching. It is the "doing" rather than the leading portion of their job that is often rewarded by the supervisors' superiors. For many managers, leaving a career of "doing" would be difficult, and would not occur unless they were convinced they had to give up what has made them successful and provided satisfaction for something that is unknown and difficult.

We see every aspect of the difficulty in creating a performance management system in the IRS employee surveys.

D. Can the IRS achieve its stated goals in the future?

Because the data shows that federal employees are not motivated to increase their performance solely because of monetary rewards, I believe it is highly questionable that the IRS can successfully implement a pay for performance system. Because federal employees are motivated to increase their performance when they are effectively led and their skills are matched to the agency mission, I believe, it is possible to increase individual and organizational performance results with the design, development, and implementation of a performance management system.

1. The performance management system must be designed, developed, implemented, reviewed, and modified based on experience in collaboration with the employees whose performance must increase.

Active, meaningful involvement of the affected employees – either through their supervisory or managerial association, through their elected representative in an organized workplace, or through non-supervisory employees in an unorganized workplace -- is critical if increased individual and organizational performance is the goal of a performance management plan.,.

It is difficult, if not impossible, to achieve necessary organizational change to improve agency performance without employees' active involvement, for the following reasons:

- A. When employees understand the linkage between their efforts and desired agency outcomes, their engagement in their work and productivity increase. Employees want their work to be clearly linked to agency goals, according to an analysis of the Office of

Personnel Management's Federal Human Capital Survey (conducted by American University's Institute for the Study of Public Policy Implementation and the Partnership for Public Service). In existing systems, many agencies' failure to clearly identify output and outcome goals has left employees unsure of the impact of their efforts. Employee involvement in identifying agency output goals will identify any difficulty in achieving those goals, and will show employees how they can contribute to the goals' attainment.

- B. Employee participation will lead to a more accurate mutual understanding of the work. Because most employee position descriptions are woefully outdated, any manager beyond the first level of supervision has little understanding of what employees do day-to-day. Only the employees who do the work can clearly describe it. Position descriptions need to be written more clearly and more accurately. Upper level management and employees need to understand better how their work is linked to that of others, and whether it impacts agency goals. Once both employees and managers understand the linkages between a given job and agency goals, the program will have more credibility.
- C. Employee participation allows managers a chance to leverage their employees' desire to make a difference to improve agency goal achievement. With dialogue, managers will learn how the work is performed, and employees will see how their work affects the achievement of agency goals.

In addition to being active, employee participation must be meaningful. It is not good enough for managers to listen to employee suggestions, retire to their offices, make a decision, announce it, and expect acceptance and enthusiastic implementation. Employees must be actively involved in the decision-making process. Dialogue, mutual listening and learning, statements of stakeholders' interests rather than of their positions, and sharing of all information used for

decision-making are all critical to making the best possible decision -- and having that decision accepted and readily implemented.

Although many substantive issues in the creation of a performance management plan are outside the mandatory scope of bargaining in the federal sector, a union does have the right to negotiate the impact and implementation of any such plan. The union also has the right to negotiate "the appropriate arrangements of employees adversely affected" (5 U.S.C. 7106(b)(3)) by the creation of such a plan. Further, the plan may not be implemented until all bargaining -- including all appeals to the Federal Service Impasses Panel, which has the authority to resolve all negotiating impasses -- is completed.

When employees through their union representatives are actively and meaningfully involved, fewer issues will be submitted to impact and implementation negotiation, and those issues bargained would take less time to resolve. The net result is faster implementation with better results.

2. The President must spend his/her most valuable asset – time – assisting the IRS and any other agency interested in successfully implementing a pay for performance system.

All Presidents have exhorted the Executive Branch to improve their performance, and blamed the Executive Branch for poor performance. Presidents spend almost all of their time creating public policy. They have typically been engaged in the traditional activities of marshalling support for new legislation, issuing new regulations that distinguish their ideas from those of their opponents, and resisting the legislative thrusts of their opponents.

Although Presidents Clinton and Bush have done more to systemically focus the Executive Branch on performance improvement than any other Presidents, they have not changed their behavior to be consistent with their role as the Chair of the Board of the Executive Branch. This role requires spending their personal

time ensuring that a vision of performance is created, performance goals are set, goal achievement is monitored, and political appointees are held responsible for public policy implementation performance goals.

If a President is serious about creating a performance management system, he/she must model the behavior he/she seeks from his/her appointees by spending his/her personal time on performance improvement. I suggest few political appointees will change their attention from public policy creation to public policy implementation without changed behavior from the President. Similarly, unless Presidents and their political appointees change their behavior, agencies' senior executives do not have either the authority or the incentive to make the changes necessary to implementing a performance management system. Even if they did, few would take the risk unless they were supported by the agency's political appointees.

3. Congress has a role to play to assist the IRS and other agencies interested in implementing a performance management system.

Congress, as an equal branch of government, has a role to play in creating a performance management culture in the Executive Branch.

Congress has appropriately spent time telling the Executive Branch what it does not want in connection with significant program failures (e.g. Katrina); however, Congress has not spent much time telling agencies what specific performance it does want in the future – and, just as importantly, it needs to allocate the funds to achieve it.

Comptroller General David Walker urged Congress to change this:

We [the GAO] have long advocated that congressional committees of jurisdiction hold oversight hearings on each of the major agencies at least once each Congress and preferably on an annual basis. Information on

the linkages among plans, programs, budgets, and program results – which should become available as agencies' implementation of performance based management moves forward – could provide a consistent starting point for each of these hearings (Walker 1999, 27).

E. Conclusion

Increased performance is a goal sought by presidents, political appointees, members of the Senior Executive Service, mid-level managers, union leaders, and employees. Harnessing that energy to actually improve performance in the Executive Branch requires the collaborative involvement of all parties.

It is possible to increase performance, but it is not easy.

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Mr. DAVIS OF ILLINOIS. We will now proceed to Dr. Stan Ridley.

STATEMENT OF STANLEY RIDLEY

Mr. RIDLEY. Thank you, Mr. Chairman.

Most of us remember the political quip, "It's the economy, hmm." To cut to the basics here, it's the basics, hmm, and the people, hmm.

What Delegate Norton pointed out was that to design and implement an effective performance appraisal, performance management, and even a pay-for-performance system, the knowledge and skills have been here for decades. People get in the way.

I should mention that my roles in the government over a decade have included being a coach, an organizational change management expert, a performance appraisal and management developer, teaching courses on supervising and human resources, etc.

The bottom line is that these things do not work as they should because they are either designed inappropriately, or, more often, they are implemented in a way that are not consistent with the basics of how they're supposed to be done. That is the fundamental problem.

When you look at the SEC, an article is attached my testimony about pass/fail. Over a decade ago I used a group of employees in the government, all levels, and we went through an exercise the appropriate way, and they discerned that pass/fail had no chance of being successful. About 6 months later, pass/fail was chosen. Did anybody mention pass/fail today? In the SEC case, they used pass/fail. The bottom line is that the basics and cycle metrics would tell you that pass/fail could never work, and a group of employees, when given the right information, were able to make that decision more than a decade ago.

The bottom line is that the knowledge and skills are there to make any system that is designed to motivate employees to perform at their maximum and then to compensate them appropriately, but if we do not employ those the right way, it would never work.

The key thing I learned about 10 years ago was that the biggest problem in terms of the government—they have some excellent employees, and I am not saying that to be PC—accountability. That was such an issue that I had to define it, and by that I meant consequences, positive or negative, based on how well you do what you are supposed to do.

How is it that we have the knowledge and skills to design these programs and implement them the correct way, but they have failed? It is not a knowledge or a skill issue. It is the failure to use the knowledge and skill issue and to adhere to whatever it is that you develop.

One of the things I should say about the Federal Government, when I read these documents, boy, they sure look good. You even see in my testimony, I made a faux pas when I made a comment, although I did use the word "appear," about what I call the pay side of pay for performance. I say, well, it appears like that is not too much of a problem, OK? But if you delineated an example of how that particular approach has been misused—and that is what I have seen over time, either underuse, nonuse or misuse of the ba-

sics that will allow you to design and implement these systems correctly, and the way in which you make sure that people actually do that is that you consistently and appropriately hold them accountable.

Any time you see a system that has failed, I will show you, I can show you, that there was a failure to appropriately and consistently hold people accountable for what it is that they do.

That's the short version of my presentation. I will make a couple of recommendations, because that's what this really should be about, as to the performance appraisal side of this.

We have—the OPM developed what is called a PAAT, a performance appraisal assessment tool. It's a good tool. It shows that they have made progress over the last 10 years. But that tool is not sufficiently aligned with what we want pay for performance to be. A concrete example, the tool says that if you meet the criteria at the 80 percent level, you are certified. The problem is that tool includes some very good items. Ask yourself this question: If the item is important, why is it that you can fail on 20 percent of them, and then you are certified? These are basics.

The next thing in that tool, they have items that use the word "adequate." Why would you have as a standard—Delegate Norton, you mentioned standards—adequate in a tool that's for the whole government that is supposed to let us know what we are supposed to be able to do.

Other inconsistencies, these are basics, is the pay for performance is supposed to be results-focused. Great concept, no problem. Yet in the actual performance appraisal plans, individuals are required to have at least one performance element that is results-focused. That's what we call internal inconsistency. If results focus in what it's about, and I have five elements, why is it that only one is required to be results-focused? These are all basics.

To cut to the chase further, in the PAAT, a number of excellent things they have are either suggested or recommended. If they are so good, why is it not required?

When you start talking about pay for performance and the valuable performance management, how about this as a recommendation? A sizable bonus should be awarded to each agency executive whose performance appraisal system is shown to be clearly valid and reliable in design, and here is the key thing: design and practice. Where we come up short most times is in the practice, based on a qualified objective review and a 100 percent pass score.

My point is really simple. The knowledge and skills necessary to have an appropriate performance appraisal, performance management, pay for performance, whatever you call it, those requisite knowledge and skills have been here for decades. We misuse, underuse or fail to use the appropriate criteria.

For example, I was surprised when you mentioned this misuse about COLAs. That shows a fundamental lack of understanding about what we call systems. See, a performance management approach should involve the PAAT system so you shouldn't be robbing Peter to pay Paul if it's unfair.

So when you sit down to design these things, what you tend to do, we design processes, not systems. Concrete example I use is a car. Why would you suggest that you could have an effective per-

formance appraisal system, and you don't have to have a real performance plan, a valid and reliable one?

I had mentioned in my testimony, it's kind of analogous to having a car and saying, we recommend that you have a steering wheel and a speedometer, but you don't have to have one. The performance plan is supposed to guide that person throughout the year, but you are supposed to get clear expectations up front and then reinforce them.

The last one I will mention is the acronym that I used. It is so simple, but if it is used consistently in the design and implementation and evaluation of any system, that system will work better. It's called CARE. You must have Clear, Aligned and Reinforced Expectations. Any system that you all point out that has failed, I will show that you there is a failure in one or more of those four pieces.

Thank you.

Mr. DAVIS OF ILLINOIS. Thank you very much.

[The prepared statement of Mr. Ridley follows:]

**Congress of the United States
House of Representatives**

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

**Subcommittee on the Federal Workforce, Postal Service and
the District of Columbia**

Written Testimony Documents

Submitted for Meeting

On

February 12, 2008

By

**Dr. Stanley E. Ridley
President & CEO**



RIDLEY & ASSOCIATES, LLC



EXEMPLARY HUMAN AND ORGANIZATION DEVELOPMENT CONSULTING

Pay-for-Performance:

Some Observations and Recommendations About the Federal Government's "New"
Approach to Performance Management/Appraisal (PM/PA)¹

Ultimately, *performance* is the *raison d'être* for any organization and its workforce, regardless of its indicators (e.g., quality services, income, effective regulations, and satisfied customers). Thus, few miss the obvious irony in the federal government's "new" approach to PM/PA being called "pay-for-performance." Nonetheless, the goal of having an effective, efficient and fair/equitable PM/PA system is laudable, and we should maximize the benefits of this opportunity.

I have more than 30 years of professional experience assessing/testing humans' capability and functioning, and recommending ways to enhance their performance. My professional federal government experience extends more than a decade, and has included providing training and consulting on varied aspects of PM/PA. Some federal agencies' most recent PM/PA systems include concepts and techniques I developed and/or recommended. That also appears to be true regarding aspects of how those systems' are audited, via the Office of Personnel Management's *Performance Appraisal Assessment Tool*.

Throughout my professional career, I have used scientific reductionism and systems thinking to isolate the smallest number of factors that explain and address a professional issue. That approach helps avoid a chronic weakness in many of our problem-solving efforts: failing to distinguish the problem's *causes* from its *symptoms*. Typically a problem can have many more symptoms than (underlying) causes. That is definitely true for PM/PA systems.

My testimony's "cause focus" approach should help explain how to ensure any PM/PA system works well, regardless of its name. Toward that end, the three key points below are made relative to a PM/PA system's appropriate conceptualization, design, development, implementation, measurement, evaluation and periodic refinement.

1. For decades, the requisite technical knowledge, skills and tools (TKSTs) have been available, and their potential utility has been significantly enhanced by computer technology.
2. For at least a half century, it has been understood that human factors can, and do, undermine the effective, efficient and fair/equitable use of the requisite TKSTs.

¹ I have explained elsewhere (Ridley, 2007) why PM and PA should not be used interchangeably. PA should be part of PM. But I will use PM/PA throughout this document because I am not clear that every federal government agency using a P-F-P approach clearly makes the needed distinction between PM and PA.

3. The major cause of unsuccessful PM/PA systems is that human basics are allowed to make the requisite TKSTs be underused, misused, or not used.

Much of what I will suggest to address the preceding is reinforced and/or extended in the content of my attached article about pass/fail performance appraisals (Ridley, 2008b).

It is critical that a PM/PA system's decision-makers and other users understand, and appropriately and consistently apply, the information provided below. This must be done **throughout** the conceptualization, design, development, implementation, measurement, evaluation and periodic refinement of any PM/PA system.

The PM/PA system must clearly show that it provides **CARE**:

Clear
Aligned (and)
Reinforced
Expectations

To accomplish the preceding, the **CARE 3-Step** was conceived:

- (1) Obtain as much upfront input as possible about content and performance expectations from affected individuals/groups (e.g., managers, staff, stakeholders and customers).
- (2) Appropriately incorporate that input, using an *interest-based problem-solving* technique to establish clear and *evidence-based* performance expectations, components and methods that are aligned with the organization's mission, vision, values, strategies and performance goals.
- (3) Appropriately and consistently reinforce the performance expectations, components and methods via periodic and constructive feedback, and any other appropriate accountability² mechanism.

Three criteria must be used for selecting, using and evaluating any instrument, technique/method or performance standard in a PM/PA system:

Validity: Degree to which it makes *meaningful differentiation* regarding what it is conceptualized and designed to do.

²It was not until I started working with the government that I realized the criticality of differentiating accountability from responsibility. I defined responsibility as an obligation/duty, and defined accountability as the appropriate (positive or negative) consequence for how well a responsibility is executed. I also began calling accountability the "Big A" because it became clear that an accountability deficiency was the regnant reason why various government initiatives were not working as well as management, stakeholders, staff and customers would like.

Reliability: Degree of internal consistency in its design, and consistency of its results.

Practicality: Degree to which the resources needed for its development and use are not excessive, especially relative to its benefits.

Those three criteria **must** be used with the following prioritization: validity, reliability, and then, practicality. For PM/PA systems, typically the prioritization is reversed.

PM/PA: It Needs to be a System

The PM/PA components must constitute a system of aligned components. We all recall and understand the importance of this well-worn saying: “a chain is only as strong as its weakest link.” Accordingly, Senge (1990) notes that a key characteristic of a system is that its components can be graphically displayed as approximating a circle. This would be evident in a PM/PA system that clearly demonstrates CARE. Too often PM/PA “systems” are really only loosely linked sets of components with destructively diverse degrees of validity, reliability and practicality. Worse yet, some PM/PA “systems” cite key components as being only *suggested*, rather than *required*. As an analogy, think about a car not being required to have a steering wheel or speedometer, and the comparable impact of a PM/PA system that does not have a valid, reliable and practical method for monitoring employee performance throughout the evaluation cycle.

Human Basics and PM/PA Systems

A PM/PA system’s success will be clearly linked to how appropriately and consistently it addresses and/or utilizes these human basics:

Motivation: Such as Maslow’s needs (safety, security, belonging, etc.), tendency to seek pleasure (e.g., success, being treated fairly) and avoid pain (e.g., negative performance feedback), and being creatures of habit and resisting change; and,

Variability: In capability, functioning, strengths/weaknesses and work-related “styles.”

PM/PA System and Decision Makers

To offset the negative impact of human basics and to promote their positive impact, a PM/PA system’s success is contingent on a number of appropriate decisions being made during the system’s development, use, evaluation and periodic refinement. But decision makers are not monolithic in their views about PM/PA. Consider these views about PM/PA systems from some decision-makers I have encountered:

“I’ve never really needed it; I know what I, and my people, have to do”

“The one we have might have some weaknesses, but it can’t be that bad: look at [the fact that it produced] me”

“They are definitely needed to aid us in developing and rewarding others, and to deal with the atypical employee who has performance problems”

“The only thing they’re useful for is when I occasionally come across an employee who does not do what I want/expect”

From the standpoint of a PM/PA *system*, such diverse views are not helpful in decision-making contexts. The tools proposed herein such as the CARE 3-Step would at least reduce this undesirable variability.

PM/PA System Implementation: The Map Does Not Equal the Territory

In the public and private sectors, often an organization’s written PM/PA system is at least good—or, it would be with minor tweaking regarding clarity of the performance elements, and ensuring appropriate accountability mechanisms are actually used. Instead, beginning in the 1990s, it became common for organizations to develop “new” PM/PA systems and then, shortly thereafter, drop the “new” system and/or change it markedly. Such occurrences are typically an indication that the changes were largely to address the system’s negative symptoms, rather than the underlying cause(s) of those symptoms.

PM/PA System’s Deficiencies and Employee Morale and Productivity

Whenever a PM/PA System even appears not to clearly provide **CARE**, perceptions of unfairness (i.e., distributive, procedural and/or interactional injustice) among personnel are likely to ensue. The type and frequency of actual and perceived deficiencies in a PM/PA system’s display of CARE, will largely determine its impact on personnel’s morale and productivity. As proposed, if a PM/PA system is found to have a significant deficiency, its cause should be readily discernible and amenable to correction in a short period of time.

PM/PA System’s Deficiencies and Adverse Impact

Our laws about *adverse impact* in the workplace are indubitably important relative to any PM/PA system. By definition, the demonstration of adverse impact requires a two-step process. First, there must be a statistically significant pass/success rate of the highest scoring/rated employee group, relative to the employee group thought to be experiencing the adverse impact. Second, if that statistically significant difference is found, the organization must show that the instrument(s) and method(s) used to derive the pass/success rates are valid. In the proposed PM/PA approach, the statistical requirement in step #1 would essentially become useless because the fairness to be demonstrated via validity in step# 2 would already have been done as part of the PM/PA systems’ development, use and evaluation. Thus, the merit in filing an adverse impact case would be unlikely. The corollary is also true: Failure to ensure the PM/PA system clearly provides CARE increases the likelihood that an adverse impact case could be filed with merit.

Concluding Remarks

Based on the content of this testimony, what do I conclude about how the federal government can ensure that its agencies' "new" pay-for-performance PM/PA systems are successful? Do something that is clearly new. That is, appropriately and consistently provide CARE, by using the CARE 3-Step, and validity, reliability and practicality to develop, implement, evaluate and refine our PM/PA tools so they become systems that are effective, efficient and fair/equitable. And, ensure that pay and other applicable compensation methods are appropriately, consistently and clearly linked to how well the PM/PA system is designed and used by all decision-makers in the respective agencies. The result would be the type of "pay-for-performance" PM/PA systems we all could benefit from, and enthusiastically support!

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"Given organizations' stated performance goals (and measurement and human performance basics), it is inconceivable how they can really have a successful PA process with less than three rating categories for employees' overall performance."

Measurement and Evaluation

OD Lessons Learned from Pass/Fail Performance Appraisals' Predictable Death

By Stanley E. Ridley

Effective measurement and evaluation (M&E) are critical for maximum development and performance of organizations and their employees. The increased demand for effective M&E is traversing the OD landscape at supersonic speed, buttressed by the Zeitgeist, increased workforce diversity and global competition, and varied technical developments such as computer technology, *analytics* and the *balanced scorecard*.

A pillar of an organization's effective M&E should be employee performance appraisal (PA). Unfortunately, PA is in dire need of enhanced effectiveness in most organizations. As this article shows, M&E that actually delivers enhanced effectiveness must be based on solid scientific foundations. "Solutions" without clear evidence of their likely success need to be avoided. For example, the pass/fail approach to PA was hailed as a solution. Seasoned managers, supervisors, human resources (HR) personnel and OD consultants endorsed the P/F approach—not discerning it was doomed to be a failed fad. This article helps explain P/F's rise and predictable failure, and provides OD lessons learned regarding appropriate M&E/PA that can also facilitate the success of varied organizational change initiatives.

The PA Dilemma

Performance appraisal of employees is unquestionably needed, but typically we have difficulty doing them well enough so they do not cause significant problems. That dilemma is reflected in the fact that

although formal employee PA processes in the workplace date back at least to the early 1900s, major dissatisfaction with PA's problems was documented consistently during the 1980s and 1990s. For example, Schellhardt (1996) reported that, "In almost every major survey, most employees who get ... evaluations and most supervisors who give them rate the process a resounding failure". That dissatisfaction reached its zenith in the 1990s when exhortations for abandoning PAs received serious debate. Perhaps the voice with the greatest impact in this matter was W. Edwards Deming, the renowned total quality pioneer and guru. His pronounced concern about the American workplace's focus on individuals, rather than on groups and teams as done in Japan, extended to individual PAs (Gabor, 1990). Abandoning formal PAs was often precluded, however, by factors such as union nonsupport, and the government regulations and laws regarding its employees.

Major problems with PAs basically fall within three interrelated categories:

- (1) *effectiveness* (e.g., rating accuracy and fairness);
- (2) *efficiency* (e.g., time required to complete them), and
- (3) *comfortability* (e.g., fear that giving accurate negative feedback could lead to employee grievances).

Pass/Fail Performance Appraisals: Solution or Fad?

Traditionally, most PA approaches have involved using three to five rating levels

(e.g., Above Average, Average, and Below Average). In contrast, the P/F approach only uses two (official) rating levels: Pass and Fail. Reportedly, having only those two rating levels could help address PAs' major problems, key examples including: (1) effectiveness—markedly reducing concern about actual and perceived accuracy of PA ratings, especially among higher functioning employees, and the fairness of linking those PA ratings to personnel decisions; (2) efficiency—markedly curtailing the time required to monitor, record and evaluate employee performance; and (3) comfortability—employees being more receptive to seeking and accepting negative performance feedback from supervisors, and supervisors feeling less anxious about giving it, because such feedback is reportedly *de-linked* from personnel decisions.

Staunch Support for P/F Appraisals

"Sometimes the solution is worse than the original problem." That saying was prominent in my mind when I first heard about P/F appraisals in the mid-1990s and the staunch backing they were receiving from some seasoned supervisors, managers, HR personnel, and OD consultants I encountered. In contrast, many of those professionals were incredulous when I expressed doubt about whether P/F was definitely the best solution to the PA dilemma. Further, their support for P/F appraisals was unflappable, even though they were unable to provide sufficient evidence regarding such appraisals' effectiveness, and conceptual and measurement soundness.

Actually, through 1995, a major reason for the difficulty obtaining effectiveness information on P/F appraisals was because little existed. By the early 1990s, few organizations had implemented P/F appraisals and, accordingly, even fewer organizations had used them long enough to generate meaningful and reliable success data. Also, access to available P/F appraisal data was a problem. Illustratively, by 1995 only two of the federal government's corporations (and none of its agencies) were *piloting* P/F appraisals

(Office of Personnel Management, 2000). Further, although a 1994 Hewitt Associates survey suggested 2.4% of private sector organizations were using P/F appraisals, those organizations' promised anonymity as survey participants precluded knowing which to contact and ask about their success using P/F.

By 1995, the limited available data regarding P/F appraisals' success (e.g., Office of Personnel Management, 1995), and anecdotal information, suggested that supervisors tended to like P/F because of efficiency and comfortability benefits such as relative ease of use, time-savings, and avoidance of grievances; but staff had effectiveness/fairness concerns about such fundamentals as how they would be compared with employees not under a P/F approach regarding promotions, awards and reductions-in-force. Related to those concerns, I encountered situations where P/F appraisals had been adopted, and were sometimes already being used, even though the using organization acknowledged that it had not formally determined the alternative method for obtaining the PA information needed to make relevant personnel decisions.

Despite lacking evidence of P/F appraisals' success, and some limited evidence to the contrary, they continued to be hailed and their use increased. For example, in late 1995 the federal government started allowing all of its agencies to use P/F appraisals. By 2000, P/F appraisals were being used with one quarter of its huge employee workforce (U.S. Merit Systems Protection Board, 2001).

Formal evidence of P/F appraisals' non-success was available at least by 1996. Rivenbark (1996) reported that while representatives from three federal government agencies were at a conference touting the process they used to adopt and develop their P/F approach, *at the same conference* a representative from a government security agency who asked to remain anonymous informed her that the agency was dropping P/F after "several years" of use. The representative reportedly said the reason was that job applicants had *no performance information* for promotion

boards to review. When the federal government began allowing all its agencies to use P/F appraisals, it discontinued its former one-size-fits-all approach. Perhaps some of its agencies believed that although the P/F approach did not work elsewhere, it still might work in their organizations.

P/F Appraisals: Movement Toward Their Predictable Death

During the 2000s, evidence of P/F appraisals' predictable death has grown exponentially. This is highlighted, for example, by this 2004 Government Accounting Office statement: "We are concerned that a pass/fail system does not provide enough meaningful information and dispersion of ratings to recognize and reward top performance, help everyone attain their maximum potential, and deal with poor performers" (p.1). Accordingly, in 2006 a proposal was considered in the U.S. Congress to no longer allow P/F appraisals in government agencies. Regarding the private sector, I contacted four major organizations that do workplace surveys: Gallup, Society for Human Resource Management, Hewitt, and Watson Wyatt. During the 2000s, P/F's insignificance has been such that neither of those organizations had assessed, or was able to provide me with any data about, the incidence of P/F's usage.

P/F Performance Appraisals: The Autopsy

Why did the P/F approach to performance appraisals fail? The approach was based on two myths, and those myths were ostensibly aided by normal human reactions to the chronic failure of attempts to address the PA dilemma.

Myth #1: Successful Organizations Seeking Maximum Employee Performance Can Have Only Two PA Rating Levels. Not true. To help organizations progress toward maximum performance, personnel attempt to recruit, hire and promote persons most likely to perform at the highest PA level (e.g., Outstanding). Occasionally, limitations such as available salary and benefits may

contribute to organizations settling for persons projected to be only adequate performers. Over time, employees' performance should be expected to vary within at least two levels, such as (1) satisfactory (e.g., Average) and (2) better than satisfactory (e.g., Above Average or Outstanding). Although it is possible that no employee would have functioned less than satisfactorily (e.g., Below Average or Fail), such a category must exist—just in case. Given organizations' stated performance goals (and measurement and human performance basics), it is inconceivable how they can really have a successful PA process with less than three rating categories for employees' overall performance. (Recall in college how unlikely it was for students, maybe including you, to exert maximum effort when taking a pass/fail course.) Organizations can occasionally use two PA ratings levels successfully, however, when applied to components of employees' overall performance (e.g., "violating a key rule or policy").

Further, in practice, the P/F label is probably a misleading misnomer. Even staunch P/F supporters acknowledged that higher/highest level performers (HLPs) exist (such as Outstanding) among those who receive that approach's *pass* rating. But, in the P/F approach, HLPs receive no official PA rating reflecting their performance level. Accordingly, for accuracy purposes, I have suggested that P/F should be considered and called a "2 + 1 tier" (rather than a "2 tier") approach: fail and pass, plus (at least) one HLP level that will be formally determined outside the regular PA process.

Myth #2: P/F Appraisal Ratings Are Really "De-linked" From Personnel Decisions. They are not. Illustratively, employees cannot be promoted or awarded a raise if they receive a *fail* PA rating. Obviously, however, the impact of pass-fail ratings on personnel decisions is likely to be minimal because so few employees receive the failure rating.

Further, even the purported need to de-link PA ratings from important personnel decisions is specious at best. Why should

personnel decisions not be based on how well employees have performed? If there is a better method to determine the PA rating, use it—in the current PA process (rather than in another process not labeled PA).

The P/F approach's purported de-linking of PA ratings from personnel decisions is really about the HLPs. Perennially, there has been significant concern about the accuracy of HLPs' PA ratings. The P/F approach ostensibly avoids the issue: it provides no official PA rating for HLPs. Responsibility for their PA rating is supposed to be transferred to an alternative rating method (e.g., forced distribution ranking by supervisors). That rating is then considered *linked* to the applicable personnel decision (e.g., annual awards).

The purported P/F appraisal-personnel decision de-linking is most likely to result in *symptom-substitution*. Assume there is an effective alternative method for obtaining PA ratings for HLPs that can be linked to each applicable personnel decision. How would the perennial concern about HLPs' PA rating(s) not just basically transfer to the alternative method? In psychology, decades ago that transfer problem was called *symptom-substitution*: rather than addressing the real "underlying" problem in the original rating method (i.e., inaccurate PA ratings for HLPs), it essentially transfers to the alternative rating method. Subsequently, that alternative rating method, or any of its symptoms, is/are cited as the problem. That occurred with the forced-ranking method for assessing employee performance (cf., Gabor, 1990).

Endorsing P/F Appraisals: Fight-Flight Reaction, Plus Groupthink?

Given P/F appraisal's lethal deficiencies and the talent and experience of many of the approach's staunch supporters, initially I was puzzled about how they could make such an ostensibly illogical endorsement. True, some supporter had only a basic familiarity with, rather than working knowledge of, the basics in measurement—especially the technical

aspects of validity and reliability.

That group included seasoned OD consultants. But even when such basics were persuasively presented (such as in the workgroup and training examples described below), P/F supporters wanted to desperately *cling* to that approach. This led me to recall the human *fight-flight* reaction (a response when stress/fear gets too high), and *groupthink* (when group members feel such a strong need to conform that they comply even when the group's stated perception/position is erroneous—resulting in irrational decisions). Accordingly, because many P/F supporters had accumulated numerous negative and stressful experiences with PAs (e.g., angst associated with possible rating inaccuracies and the threat of, as well as actual, grievances and lawsuits), they experienced and presented themselves as basically helpless in their fight to have their organization, colleagues, clients—and themselves—do PAs validly and reliably. In reaction, their ultimate flight would have landed them where PAs were abandoned. Typically, however, as previously explained that was basically impossible. So the farthest they could have taken flight from formal PAs was the P/F approach. Further, groupthink probably buttressed the P/F support. Thus, from this humanistic perspective, the ostensible illogic of such professionals' endorsing the P/F approach essentially disappears.

Addressing the PA Dilemma: Criticality of Applying Basics in Measurement and Human Performance

Given the longstanding PA dilemma and the concomitant need to avoid pre-doomed failures such as P/F appraisals, what can be done to provide real PA solutions? Ensure that such solutions appropriately embody measurement basics: validity, reliability and practicality; and basics in human performance: motivation, capability and variability. Knowledge about those basics is readily obtainable from introductory measurement, psychology, and human development books and courses, as well as the Internet. Cited below are slightly modified versions of

Table 1: Comparison of Pass-Fail and Multi-Level PA Approaches

Criterion (Potential for)	Pass-Fail (Two-Tier/Level)	Multi-Level (Three-Tier/Level or Higher)
Validity (Including Fairness)	Low	Moderate-High
Reliability	High	Low-High
Practicality	High	Low-High

those basics' operational definitions and conceptualizations that I have typically used.

Validity: Degree to which the PAs provide *meaningful differentiation* in employees' performance related to organizational goals and, concomitantly, serve as a key source for determining who should receive special recognition such as awards, bonuses, raises, developmental opportunities, and promotions.

Reliability: Degree of consistency of the PAs' results regarding the likelihood that those results would be similar/the same if different supervisors appraised the same employee.

Practicality: Degree to which the resources needed to complete the PAs are not excessive, especially relative to the PAs' benefits.

Those three measurement basics, I believe, should be the principal criteria for selecting any M&E/PA indicator, and they should be used with the following prioritization: validity, reliability, and then, practicality. My OD experience has been that, if those criteria were used, the organizations' decisions tended to be weighted in the opposite order.

Human Motivation: Few question Abraham Maslow's view that humans are motivated to satisfy their basic needs such as safety/security. Similarly, it is generally accepted that humans tend to seek pleasure (e.g., success) and avoid pain (e.g., failure and negative feedback), and prefer to be treated fairly.

Human Capability and Performance Variability: For more than a century we have known, scientifically, that human capability and performance vary on

a continuum. Often that continuum approximates a normal curve but, depending on the type of attribute, performance and contextual factors, the variability may appropriately deviate markedly from that curve.

Below are two examples of what happened when the preceding measurement and human performance basics were applied to analyses and decisions about P/F appraisals.

Example 1. As an external OD consultant, I was privileged to work with an impressive employee workgroup consisting of management and staff who were charged with helping its organization select a PA approach as part of an overall change management initiative. The organization was having major trust issues, so it was important to foster the workgroup's diversity and, concomitantly, the perceived and actual fairness of the members' selection. Therefore, members were chosen using a stratified random sampling technique, supplemented with self-ratings regarding their degree of interest and availability. (I could not vote on anything the workgroup considered, and its members were to inform management of any behavior/comment on my part that was inconsistent with that, or any of the workgroup's other ground rules.)

An *interest-based problem-solving* technique was used to help the workgroup choose and prioritize criteria for recommending a PA approach. The workgroup selected these prioritized criteria: validity, reliability and practicality. The workgroup also agreed that each member would base his/her vote on which PA approach best fit those criteria—regardless of their personal preference. P/F was called *2-tier* (for its two official rating categories) and any other approach was called *multi-tier* (for its three or more official rating categories). Each workgroup

member could share relevant information from any source. The respective pros and cons of each PA approach were presented, and then dialogued in subgroups and by the whole workgroup.

The workgroup was about to vote on which PA approach to recommend when a slight sense of uneasiness surfaced in the room. Then an especially well-respected member brought up some issues—ones that had been previously addressed to the workgroup's satisfaction. Increased uneasiness was pervasive. Then another highly respected member asked if the vote could be delayed to another time/day—without providing any sensible reason for doing so. The uneasiness became more pronounced and the awkward facial expressions and other body gestures suggested the uncomfortability was omnipresent. What caused the preceding? It was a few members' attempted resistance to the inevitable decision—and other members' response to that resistance. Even among members with a staunch preference for P/F, it was obvious that the P/F approach was not recommendable because it did not provide the best fit according to the workgroup's decision-making criteria. Fortunately, the workgroup's development had reached a reasonably high degree of maturity. Accordingly, without solicitation, its members acknowledged that if it had not established the selection criteria beforehand, it would have taken many more meetings to make a decision—if one could have been reached at all. Further, because of the inevitable intra-group dynamics and pressures from colleagues/supervisors outside the workgroup, they reported not being totally confident that the same decision would have been made.

Table 1 shows the workgroup's final assessment was that although the P/F approach would be highly practical (i.e., little to do) and reliable (most supervisors would agree that all, or almost all, employees passed), it would provide little regarding validity (i.e., meaningful differentiation in performance relative to organizational goals). In contrast, a multi-tier PA approach could have *low to high* practicality and reliability, and *moderate to high* validity.

Example 2. I was facilitating manager and supervisor training sessions on leadership, supervising human resources, and program evaluation. Inevitably, the issue of P/F appraisals arose and needed to be addressed because the participants were actual or potential decision-makers. But P/F appraisals were not a focus of such sessions, so I developed a slightly modified version of Table 2 below to address the P/F issue in limited time.

Before showing Table 2, training participants were asked what percent of their respective workforce was likely to earn a failure rating if a P/F approach were used. With virtually no exceptions (even with my effort to encourage them), the responses were that the failure rate would be one percent or less. After participants agreed to the importance of validity (including fairness), reliability and practicality, and the presented operational definitions of them, they were asked two questions about validity. Q1: "How 'meaningful' is it to distinguish 1% or less of the employees from the other 99%?" Answer: Not much. Q2: "At the beginning of the evaluation year, what percent of employees would think they were going to pass, and what percent of them would actually do so?" Answers to both parts of that question were either 100% or 99-100%. Then they were asked, "How fair is it to treat the performance of everyone in the pass category like their performance was the same or comparable?" The answer: Not very fair because those with a pass rating are likely to actually fall within more than one actual performance-rating category. Table 2 shows that it is possible to actually have (at least) five performance groups within the pass category, depending on the degree to which they met, exceeded, or did not meet basic expectations.

Many training participants expressed disbelief when they saw that the highly touted P/F approach was so fundamentally weak regarding its validity. Nonetheless, after first acknowledging the veracity of Table 2's information, some training participants still suggested that maybe P/F appraisals should be given "a try." About 1-2 years after those PA training sessions, I was informed that an office in a

Table 2: Analysis of Possible Unfairness of the "Pass" Rating in the P/F Approach

Employees Who "Passed" = $\geq 99\%$		
Minimum Requirements	Exceeded Minimum Requirements	Possible Ratings
Passed-Plus 3	Often Much More	Outstanding/Superior
Passed-Plus 2	Occasionally More	Excellent/Highly Successful
Passed-Plus 1	Rarely More	Satisfactory/Successful
Passed-Barely	Basically Nothing More	Minimally Satisfactory/Successful
Passed—But Should Have Failed	Basically Nothing More—and Sometimes Notably Less	Minimally Satisfactory/Successful
Employees Who "Failed" = $\leq 1\%$		
Failed (and Should Have)	Basically Nothing More—and Clearly Notably Less	Unsatisfactory/Unsuccessful/Failed

government agency was going to pilot a P/F approach. That office included supervisors/managers who had participated in at least one of those training sessions.

Summary, OD Lessons Learned/Recommendations

"If I only knew then what I know now." Despite the importance of M&E and the longstanding PA dilemma, there should have been no opportunity for such Monday morning quarterbacking regarding the P/F approach to performance appraisal (PA). That approach should have been rated *fail* before it initially received a *pass* to be used. The approach's adoption was neither consistent with the prioritized measurement basics of validity, reliability and practicality; nor human basics regarding motivation, and performance capability and variability. The failure of P/F supporters to appropriately consider and use those basics was probably related to a fight-flight reaction, buttressed by groupthink. Moreover, two of the P/F approach's purported key benefits are essentially myths: requiring only two PA rating levels, and those rating levels being de-linked from personnel decisions. Appropriately, P/F appraisals have essentially achieved their predictable death.

So, for OD practitioners what lessons can be gleaned from the grand *faux pas* of the P/F approach to PA? The recommendations below reflect such lessons, and could prove especially valuable because most extend beyond M&E/PA to other organizational change initiatives.

- (1) Specifically, for PAs' overall rating levels:
 - (a) do not predetermine their number;
 - (b) select the largest number that best fits the prioritized selection criteria of validity, reliability and practicality; and,
 - (c) if less than three levels are selected, revisit 1a and 1b.
 (The preceding PA recommendations are in addition to those frequently cited basics such as aligning the ratable performance elements with the organization's mission and performance goals, providing individual employee performance plans, and requiring periodic and constructive performance feedback.)
- (2) For M&E, PA and Other Change Initiatives:
 - (a) OD practitioners should remember to continually use methods that ensure that we have the requisite knowledge, skill and experience to make recommendations, and

work on projects, regarding a given technical area within OD's purview (e.g., validity and reliability of M&E and PA);

- (b) relevant human basics (e.g., motivation and capability) should be understood, acknowledged and factored into the process regarding their potentially positive and negative consequences—although this is typically attempted, for example regarding types of resistance, too often it is not done as effectively as needed;
- (c) select appropriate decision-making criteria *before* deliberations begin about options regarding the change(s) being considered;
- (d) make decision-making criteria as transparent and objective as possible via well-crafted operational definitions;
- (e) if applicable, appropriately prioritize the decision-making criteria;
- (f) have the decision-making team be as diverse as appropriate and possible (e.g., upper and middle management, human resources, supervisors, staff and clients/customers);
- (g) ensure that the decision-making team will be held accountable for adhering to its agreed-upon (prioritized) decision-making criteria;
- (h) have at least one expert (external—if the required degree of objectivity is more likely) verify the appropriateness of the operationally defined and prioritized criteria *before* deliberations begin;
- (i) have the same/comparable expert(s) verify the degree to which each recommended decision aligns with the decision-making criteria; and,
- (j) establish valid and reliable mechanisms for accountability during and after the change process (that *actually* hold the applicable people accountable).

If the preceding recommendations are followed, not only can an organization's

M&E, PA and other change initiatives be more likely to succeed, their success level will probably merit an award. So be sure to have predetermined and fair M&E criteria for that purpose too—that go beyond merely asking if the change effort passed or failed.

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Mr. DAVIS OF ILLINOIS. We will go to Mr. Max Stier.

STATEMENT OF MAX STIER

Mr. STIER. Thank you.

Thank you as well, Congresswoman Norton.

It's a pleasure to be here. It's very important that you hold this hearing.

I would ask that this committee take a step backward for a moment and ask about not just pay for performance, but pay for performance more generally, because what I would argue is that the government is making distinctions around personnel issues in a variety of areas that don't receive sufficient attention. So, for example, whether it is hiring or promotion or decisions around pay, government managers are making decisions that are based upon systems that sometimes are working and sometimes not. It's only because we are looking at efforts to change the system right now that there's real attention being paid here, and I think it would be worthwhile to focus on performance issues more generally, understanding how it is we are making distinctions, and how to use those distinctions in a way that truly and effectively and appropriately promote performance.

Rather than looking backward, looking at issues and the stakes or problems, I would propose six different recommendation that we would make; first and foremost and most important, the clear need to collect data and publish that data on a regular basis. We see examples here of that, when Mr. Tobias talks about the Human Capital Survey. In fact, his data points to the fact that it is not pay-for-performance systems that are generating problems in the work force, it's actually the whole system itself.

General Schedule employees are raising issues about the pay that they are receiving, about the leadership that they are receiving. These are issues that are systemic and that we need to address governmentwide. We need specific data efforts, collection efforts. When you are talking about system change, we propose seven different buckets of data that ought to be collected around recruitment, retention, skills gap, performance distinctions, performance culture and, ultimately, as the last witness has testified, around implementation. That data is quite important because it will allow you and other decisionmakers to understand what is happening in real time when these changes are being implemented.

Second, fundamentally, I believe, and you see this again and again, you need true engagement and buy-in from the employees and employee organizations. Unless that happens, there is simply not going to be any success. Ultimately, when you think about performance management systems, you are ultimately trying to encourage employees to provide this, as Bob would say, their discretionary energy. How can they do that if they don't buy into the system? Therefore, that has to be a foundational element of success.

Third, before moving to pay systems, again, and this is something you have heard from other witnesses, you really need to make sure that your performance evaluation and your larger performance management system is working.

Fourth, managers have to receive the training, the support in order to be able to successfully use these systems. When you are

asking them to make distinctions, you need to make sure that they are getting the tools that will enable them to make them appropriately. Ultimately they need to be held accountable. They need to understand that organizationally this is an important part of their work. By and large these are challenging, difficult issues, and, given a choice, most managers would rather do other things. So it's very important to make sure that they understand that they themselves are being judged on their performance with respect to the way that they are judging the employees that they are supervising.

Fifth, we need to make sure that we give these systems time to actually change and time to actually work. It's important to collect the data. It's important also to realize that change is difficult of this sort all the time, and you are not going to see a turnaround immediately.

If you look at some of the data points from some of the demo projects, you actually see increased buy-in from the employee base over time, and that is something I think again is vital; that we make sure we understand that these things, A, are not likely to be gotten right the very first time, that they are going to take time to actually work through the issue and to get the buy-in that's necessary.

Finally, No. 6, I would propose that this committee and Congress more generally has a critical role in providing the resources to make sure that the systems are resourced appropriately, and that the work force is resourced appropriately, and that you give this kind of attention to the changes that are necessary.

So thank you very much.

[The prepared statement of Mr. Stier follows:]



PARTNERSHIP FOR PUBLIC SERVICE

**Written Testimony of Max Stier
President and CEO
Partnership for Public Service**

Prepared for

**The House Committee on Oversight and Government Reform
Subcommittee on the Federal Workforce, Postal Service, and
the District of Columbia**

Hearing Entitled

**“Robbing Mary to Pay Peter and Paul: The Administration’s
Pay for Performance System”**

February 12, 2008

Chairman Davis, Representative Marchant, Members of the Subcommittee, thank you very much for the opportunity to appear before you today. I am Max Stier, President and CEO of the Partnership for Public Service, a nonpartisan, nonprofit organization dedicated to revitalizing the federal civil service by inspiring a new generation to serve and transforming the way the federal government works. We appreciate your invitation to discuss pay for performance in the federal government.

The Partnership has two principal areas of focus. First, we work to inspire new talent to join federal service. Second, we work with government leaders to help transform government so that the best and brightest will enter, stay and succeed in meeting the challenges of our nation. That includes all aspects of how the federal government manages people, from attracting them to government, leading them, supporting their development and managing performance; in short, all the essential ingredients for forming and keeping a world-class workforce.

The question that frames our discussion today is, “How can we create a higher performing work environment in federal agencies?” Pay is one way to motivate federal employees to perform at their best. It is not the only or most important way – indeed, the Partnership’s *Best Places to Work in the Federal Government* rankings demonstrate that compensation is not the most important driver of employee engagement – but pay can be a valuable tool in recruiting, retaining and motivating talent and improving individual and organizational performance.

The merit system principles in Title 5 recognize that incentives and recognition for excellence in performance are appropriate. But the current 1949-era General Schedule system does not reward high performers. It rewards, above all else, longevity. The length of time that someone spends in their job should not be the primary consideration in compensation decisions. To compete for the talent that government needs today and for the foreseeable future, the federal government must move toward a more performance-sensitive compensation system.

As this Subcommittee has learned through your oversight efforts and past hearings, the record of alternative personnel systems with a performance-based pay component is mixed. We know from the 2007 analysis completed by the Office of Personnel Management¹ that many agencies consider their efforts to be a success. However, various media reports and testimony before this Subcommittee tell a cautionary tale about the ease with which such efforts can and do go awry. The challenge for the federal government, Congress and stakeholders is to learn from these experiences – both the good and the bad – and apply those lessons going forward.

¹ Office of Personnel Management, *Alternative Personnel Systems in the Federal Government*, 33-38, (December 2007).

Performance-Based Pay: A View from the Chief Human Capital Officers

In our July 2007 report² on the views of federal agency Chief Human Capital Officers (CHCOs), the Partnership found that while a consensus has yet to form on what a new government-wide pay and performance system should look like, the clear majority of the 55 CHCOs and senior HR professional interviewed think the General Schedule pay system is no longer adequate. More than half of the respondents agreed that a more performance-sensitive pay system should be a long-term goal. Several interviewees praised the results of pay for performance demonstration projects as examples of responsible ways to further strengthen the link between performance and compensation. One-third of those interviewed said we should scrap the GS system immediately. Most cautioned that the process to design and implement a new pay system should be slow and deliberate and that credible performance management systems and appraisals must come first. A number want to wait and see how ongoing transitions to pay for performance play out elsewhere in government before moving forward with any major changes for their agencies. Most of the concerns expressed about performance-based pay stem less from the policy itself and more from the fact that attempts to implement reforms at DOD, DHS and with Senior Executive Service (SES) pay have been controversial.

Our report found mixed reviews for the performance-based pay system established by Congress in 2003 for the SES. Respondents suggested that the timelines were too aggressive, and CHCOs said they did not receive clear or consistent guidance from OPM. Several complained that they still did not know exactly how to get their SES performance-based pay system certified by OPM.

Still, the overwhelming sense of government's senior HR leaders can be summed up by the comments of one CHCO: "Congress needs to understand the General Schedule is not working. Maybe we need to take baby steps – but we can't just go backwards."

A Way Forward

Colleen Kelley had it right when she was quoted as saying that performance-based compensation systems succeed only when they rest on a "trilogy of ideas" – fairness, credibility and transparency. We could not agree more. Indeed, Congress recognized that a fair, credible and transparent employee appraisal system is a necessary precondition to a pay for performance demonstration project. The only way to achieve credibility – the necessary "buy-in" from agency employees – is for federal agencies to work with employees and employee representatives to design, implement and assess the impact of performance-based compensation.

² Partnership for Public Service, *Federal Human Capital: The Perfect Storm, A Survey of Chief Human Capital Officers*, July 2007.

It is hard work but we know that it is possible to build consensus around the mechanics of a performance-oriented pay system. For instance, the National Treasury Employees Union (NTEU) reached agreement with the National Credit Union Administration (NCUA) last year on a compensation system that will reward employees commensurate with their performance. Previously, NTEU also reached a collective bargaining agreement with the Securities and Exchange Commission (SEC) and the Federal Deposit Insurance Corporation (FDIC) on their performance-based pay systems. In the latter two cases, however, there have been disagreements regarding the implementation of those systems. The point remains, however, that consensus is possible regarding how such a system should work. Of course, federal agencies still need to ensure that such systems actually operate as intended and they need to take corrective actions when they do not.

We know that performance-oriented pay systems falter when there is inadequate attention to the vital ingredients of employee involvement and communication. Simply put, a pay for performance system is doomed to fail if the affected employees do not perceive the system as fair for all, regardless of gender, race, religion, political affiliation, marital status, age, veteran status or disability. Employees must be confident that personal favoritism will not advantage or disadvantage any employee. And the best way to ensure the fairness, credibility and transparency of a pay for performance system is to measure its impact on affected employees. This is one of the reasons that the Partnership for Public Service tracks employee perceptions of performance-based rewards and advancement in its *Best Places to Work in the Federal Government* rankings.

Failure...or Success?

Why do some pay for performance systems succeed while others fail? If the objectives of pay for performance systems are to attract, motivate and retain talent and to create higher performing organizations, experience suggests that current and recent efforts to implement performance-based pay have had mixed results. Problems in unsuccessful systems can often be traced to lack of communication with employees, overly ambitious timelines, ambiguous goals, inadequate guidance and poor assessment.

To ensure that future efforts have a high likelihood of realizing objectives, the Partnership offers the following recommendations:

1) *Create and employ meaningful measures to identify the positive and negative impacts of pay for performance systems and to ascertain the impact of such systems on various demographic groups.*

Performance-based compensation for federal employees must not advantage certain demographic groups over others. The Government Accountability Office took the bold step of publicizing the agency's promotions and performance ratings by race, gender, age, disability, veteran status, location and payband. The data revealed a gap between performance appraisals for African-Americans and whites, a disparity that the agency is now able to address. Measures are an absolutely critical ingredient in determining

whether pay for performance rewards employees fairly and whether changes in the system are needed.

Based on the Partnership's research, we recommend that the Subcommittee work with agencies pursuing pay for performance systems to create, collect and analyze **measures in seven areas: recruitment, retention, skills gaps, performance distinctions, performance culture, leadership and implementation.** We also recommend the creation and collection of this data by **specific demographic group** – e.g., minority employees or a particular age group – as compared to the workforce as a whole. The data should be collected and analyzed with the objective of determining the impact of performance-based compensation in each of these important areas.

As previously mentioned, the Partnership's *Best Places to Work* rankings include a dimension on performance-based rewards and advancement. Agency scores on this dimension are driven by employee responses to a variety of statements, including:

- Promotions in my work unit are based on merit
- Employees are rewarded for providing high quality products and services to customers
- Creativity and innovation are rewarded
- My performance appraisal is a fair reflection of my performance
- Satisfaction with recognition received for doing a good job
- Satisfaction with opportunity to get a better job in organization

2) *Engage federal employees and their representatives in the design, implementation and assessment of the pay for performance system.*

A performance-based pay system that is imposed upon, rather than established with, agency employees will not further the goals of better employee and organizational performance; indeed, it may have the opposite effect. For example, the Treasury Inspector General for Tax Administration said in a 2007 report that the IRS pay for performance system may not support initiatives to recruit, retain and motivate future leaders in part because the IRS did not sufficiently communicate the details of the new pay system or attempt to seek support from the affected managers. Congress should insist on demonstrable, meaningful agency engagement with employees and their representatives at all points in the process.

3) *Ensure that any pay for performance system is based on a sound performance management system.*

Employees and their managers need a common understanding of how performance is measured, how performance will be evaluated and how pay decisions are made. Congress should require that an agency's alternative pay system meet certain requirements, and be certified by OPM, GAO, or another entity specified by Congress, before it is implemented. The requirements for certification should include (a) a fair, credible and transparent performance appraisal system, (b) a means of ensuring employee involvement and ongoing feedback, (c) a mechanism for ensuring the system is

adequately resourced, and (d) meaningful measures to quickly identify positive and negative impacts and ascertain the system's impact on various demographic groups.

4) Managers must be trained and held accountable for unbiased and transparent decisions regarding performance assessment and pay decisions.

As agencies have abandoned pass/fail employee appraisal systems in favor of multi-tiered systems that recognize meaningful distinctions in performance, it has reinforced the need to ensure that federal managers are well-trained to implement these new systems. In the Partnership's 2007 report on the views of Chief Human Capital Officers, many CHCOs stressed the importance of sensitivity to employee needs and effective communication by federal managers. As one CHCO said, "Writing an effective performance review is not intuitive." These skills must be taught, and trained managers must be held accountable for implementing the system fairly. Indeed, the performance appraisal and compensation of managers should be linked directly to how successfully they are managing and communicating about performance with their subordinates.

5) Allow performance-based pay systems time to mature before making a final evaluation.

A January 2004 GAO report (GAO-04-83) based on an examination of pay for performance approaches at six established demonstration projects found that the pay-banded, pay for performance demonstration project started in 1980 at the Department of the Navy's China Lake Naval Weapons Center, for example, was initially favored by only 29 percent of employees. By 1998 that number had grown to 71 percent. It's clear that the process of making major changes in federal human resources systems, especially in pay and performance management, involves culture change as well as system change. Such change is inevitably slow and iterative. Attempts to implement performance-based pay in the federal government have a mixed track record, to be sure, especially in terms of employee acceptance. We note, however, that a number of the federal agencies that have been allowed to operate under alternative personnel systems have consistently been rated by their employees as among the top ranked "Best Places to Work."

6) Congress must allocate resources to enable the success of pay for performance in federal agencies.

Congress should closely monitor agencies' investments in training, development and employee compensation. Too often, training and development accounts are among the first to be cut when the fact is we need to be investing more in training and development, particularly when we are demanding more of managers and implementing a new system. It is also essential to ensure that adequate resources are in place to enable each federal agency to compensate its employees in accordance with the agency's pay for performance system.

Conclusion

In summary, we believe that movement back to the 1949-era General Schedule or a rollback of existing authorities supporting performance-based compensation would likely have greater costs than benefits. None of the alternative personnel systems have been “magic bullets,” but over time most have been improvements over what existed previously and the affected organizations would be loathe to return to the previous state. The challenge, therefore, is to effectively move forward from here and ensure that pay for performance systems meet the objectives of helping to recruit, retain and motivate talent and improving employee and organizational performance.

Mr. DAVIS OF ILLINOIS. Thank you very much, and I want to thank each of you.

I want to ask each of you one question. I will begin with you, sir.

In your testimony, you recommend that GAO conduct a study and audit of statistics that involve pay for performance. Would you explain why?

Mr. STIER. Certainly, Mr. Chairman. In the past year, GAO's Office of Strategic Studies has done two extensive surveys, one governmentwide about the SES and the other governmentwide about Hispanics, of employment statistics. They have experience, and they have the data base. There is the CPPF data base. It exists already. It is not just that it has to be brought into existence.

Using this data base and perhaps a limited supplemental information, which this same office has used before, they did a report in 2004 about the demonstration pay-for-performance projects in existence at the time. Using their existing skill set and their existing data base, they could produce the statistics that would show who the raises have been going to in SES and NSPS and the IRS managers system and so forth. The statistics that they could produce would determine which units in the government have the kind of statistics that the arbitrator found at the SEC, that the arbitrator ruled that the SEC made out a prima facie case of discrimination.

If they simply run the numbers up—I say simply, it's a considerable effort to do that—but if they were to take the systems that they are operating now, we could find out which units have what is in effect a prima facie case of discrimination going on using the pay-for-performance system.

Mr. DAVIS OF ILLINOIS. Let me ask. Why do you think that the Federal pay-for-performance systems are failing? And what if any legislative changes would you recommend?

Mr. TIEFER. Well, I think they are failing to take them in a different order than I originally stated it. The No. 1 reason that they're failing is that there is no new regular funding, basically no new funding being put in for the performance bonuses. And if you look at this—if you survey the literature on pay-for-performance, what makes for success is if new money is put in so that the employees accept—employee acceptance goes with the system. Even if some employees don't get bonuses, they say, well, we didn't lose anything from it, so we are not going to fight the system; it's not embittering us.

The fact that no new money is put in is exactly why the title of this hearing, robbing Mary to—I'm sorry—I get it mixed up. I get it mixed up. I get it mixed up between Mary, Peter and Paul. It's the same as the pay-for-performance system. It is hard to figure out who it is coming from and who it is going to. But if you don't put new money into it, you know, you don't have any net winners; just as many losers as winners.

And that is unfortunate because—let me add—a second—the second reason is that we're using not—we're using a value of ratings which were rushed into operation without giving them time to reach the validated stage. Ms. Norton talked about—and rightly so—the criteria that are used to determine whether you have employment discrimination in the private sector. If you're going to

have an impact, if you are going to have an employment system that may have a statistical impact that is not age neutral and is not race neutral, then it has to be the private sector title 7 litigation as shown validated. The systems we're talking about here have not been validated. They couldn't be validated. Those are the two basic reasons.

Mr. DAVIS OF ILLINOIS. Thank you very much. Dr. Fay, last year you testified before the subcommittee regarding a market based compensation study conducted by Watson Wyatt for GAO. Given your findings, would you recommend that GAO continue to use the Watts Wyatt study as a basis for determining pay at the GAO?

Mr. FAY. I wouldn't use that study for the basis of anything.

Mr. DAVIS OF ILLINOIS. Could you elaborate?

Mr. FAY. Well, as I testified before, the method of data collection for that survey, the definition of jobs, the job comparability, that is, the market matches that they made were inadequate. The surveys they used did not have, in my judgment, the appropriate sample comparators, and the way they utilized the data to come up with the numbers they did—well, the second or third time they did it—were I think misleading and inaccurate or gave inaccurate results.

Mr. DAVIS OF ILLINOIS. Well, let me ask you. If validated performance management systems are a prerequisite to the implementation of successful pay-for-performance systems, why do you think agencies have focused more on implementing credible performance management systems?

Mr. FAY. Well, I would disagree that—it is very difficult to validate a performance appraisal. Performance measures are usually what is called a criterion variable. In selection, for example, you predict in the selection process, you predict toward performance. You have to use content validation methods with performance appraisal systems. And my dissertation was on errors and performance rating. And I recall all too well how many rating errors can dance on the head of a pin. It is not easy to do. And for that reason, there is a number of people who have said it is really critical that you get buy in from employees and employee organizations. This has to be a collaborative process, whereby people recognize that what they're doing is aimed toward improving performance of the organization as a whole and rewarding those who most help that; not a system where you have kind of a gotcha after the fact.

This is a—one person mentioned that planning is critical. If performance planning is done correctly by a manager and his or her direct reports, much of the rest of it falls into place. The problem is when you have these generic criteria—which by the way in my opinion are against the OCCP rules on dealing with selection and so forth and validation of decisions, primarily selection decisions. They state specifically in those rulings that they have to be job-specific. And these are not job-specific. And you see people twisting, trying to get an employee's actual duties and responsibilities and behavior and so forth, outcomes to match those. If you're going to be rating performance, you should decide what is important in performance on an individual and discuss it with them, coach and counsel them over the year to get them there. And the summary

rating at that point becomes a—almost a nonevent. In these systems, the summary rating is to me the total event.

Mr. DAVIS OF ILLINOIS. Thank you very much.

Delegate Norton.

Ms. NORTON. Mr. Chairman, let me try to get my arms around some of this.

Mr. Stier, in describing failure or success on page 4 of your testimony, problems with unsuccessful systems often traced—and then you list—communication with employees, overly ambitious timelines, ambitious goals, inadequate guidance and poor assessment. Do you believe that you can implement—because you have been a defender of these systems. And as I've indicated, there are circumstances in which these systems are more than defensible. Do you believe you can—you can have a successful pay-for-performance system if there has been no validation of the performance criteria?

Mr. STIER. I would say—I mean, I think the position of the partnership is very much akin to—I'm sorry—the position of the partnership for public service is very, very much akin to what you describe, which is that these are very difficult systems to get right. It is possible to get right, but they require quite a bit of effort and effort that is really very much focused on the individual manager in that relationship between the manager and the—

Ms. NORTON. What do you think the systems—the criteria—the criteria for judging the employee would need to be validated?

Mr. STIER. I think that, again, as some of the earlier witnesses stated, that you're not going to be able to validate each individual performance plan that the employee has. You can and ought to be collecting information on whether there is an adverse impact with any system that is being put in place.

Ms. NORTON. You just described what happens if a plan has not been val—in other words, you're all saying that you do not believe that a system would be valid if it discriminated on the basis of race, sex or age?

Mr. STIER. Correct, correct. I think you have to look—

Ms. NORTON. The only way in which we found to keep that from happening is to require employees to suspend what has now been if I can be clear, since 1960, billions of dollars, an incalculable amount of dollars, in order to validate systems so that indeed they can use them. And here I've not gotten to the Federal employ—the Federal Government has paid—and I don't know how much—but it also has paid a boatload of dollars. But in the private sector, which led the way on validation, people went to the trouble of the kind Dr. Fay has described of validating each job. And you have just told me what you can expect to do that.

Mr. STIER. To be clear, my point is that I think you're absolutely right that we've under-invested in ensuring that these are the right systems. I think—

Ms. NORTON. I just want to know—you can't take—the position that you're taking is a position to which I'm sympathetic. You are not the best defender of that position if you seem to be, as you—as part of your answer seems to say, that even in the Federal Government, those systems can be used if they show discrimination. This is very late in the game for either the private sector—and I

want to stress this—or the public sector, either sector to put into place performance criteria that discriminate, except the private sector doesn't have the overlay of the Civil Service system so the arbitrator throws the whole kit and caboodle out. Do you think that would, if it were appealed to court, survive?

Mr. STIER. Congresswoman Norton, just to be clear, if I have left you with the impression—

Ms. NORTON. You certainly have left me with the impression that you are generalizing across the board. This testimony does not even mention validation.

Mr. STIER. Oh, I think it does. It certainly talks about adverse impact, and it refers to the finding that you're describing there.

Ms. NORTON. You can't avoid—you can't avoid what we're investigating here. What does the Government have to do in order to avoid adverse impact? And that's what I'm asking you. Isn't the case law—isn't the state of art of the profession that you have to take the trouble and you have to spend the money to validate whether you're a GM, Toyota or the Government of the United States?

Mr. STIER. I will—there are other experts on the validation process here on this panel. What my understanding is, you certainly need to look to see if there is any adverse impact. If you will look at our testimony, we are very supportive of the idea—

Ms. NORTON. I take it you're for validation. That's all I wanted to make sure.

Mr. STIER. Certainly.

Ms. NORTON. But you have something in your testimony that concerned me. You haven't paid—something else in your testimony. You see, the over—what you are trying to do overall is important. But you don't do a service by mitigating how difficult it is going to be. And you particularly don't do us a service—if I may say so, I've been on the other end of this where I have been part of an enforcement agency that forced the private sector to spend all of this money. Here I now come to the Congress of the United States having remembered all that, billions of dollars that the private sector had to spend. Which, yeah, they'll say the same thing, could it have gone for something else. And we want to apply a lesser criteria to a system that has also due process built into it. On page 4, you tell us—boy, I think this would be a headline, and I'm going to let them speak for themselves. But you tell us that the NTEU has reached agreement with the National Credit Union Administration on a compensation system. See? It can be done. One of the—one of the great unions in—who is a tough union, has already reached agreement that will reward the employees commensurate with their performance. Did you think we weren't going to check that out? Especially since—as a matter of fact, we know they can bargain for pay-for-performance. And then you say previously NTEO, EEU—and again I just think this ought to be a banner headline, particularly in the Washington Post also where so many Federal employees are—also reached a collective bargaining agreement with the Security and Exchange Commission and the Federal Deposit Insurance Corporation on their performance pay system. Why didn't you say the arbitrator had thrown it out?

Mr. STIER. Congresswoman, I'm very confused here as to what your concern is. These are all factually correct statements. We have not misrepresented anything at all. And I'm happy to explain any——

Ms. NORTON. I have just—you can explain—you can correct what I just asked you. I have put facts before you. I said they can bargain for pay-for-performance.

Mr. STIER. I'm sorry. As I understood what you said, is you said we had made a statement that there had been an agreement between the National Credit Union Administration [NTEU], and in fact, that is correct. There has been an agreement. I'm not understanding exactly——

Ms. NORTON. According to the union, there has been no such agreement. I'd be very interested in hearing that statement because there has in fact been a——

Ms. NORTON. And according to the union—and according to the union, with the SEC, there was impasse. And you know what impasse means?

Mr. STIER. I do.

Ms. NORTON. It means that you can't reach agreement with your union, so you then go to have—have the system impose——

Mr. STIER. Congresswoman Norton, the testimony is intended to be helpful to you. I apologize if it is not. I don't believe there are any factual inaccuracies, but we'll of course correct them if there are any.

Ms. NORTON. I'm going to let them speak for themselves.

Mr. STIER. I'd like to hear if there are any——

Ms. NORTON. This is a fine art, and this is a very technical matter. And really what we have to get down—down to because I find most of your points, points I'm in agreement with, and I think everybody else on the panel would be in agreement with your points about, you know, getting employees to buy in and the rest. You know, that doesn't get to what is the nub of the problem, extremely technical, reams of litigation, lots of money spent both on litigation and on validating system, shouldn't have to go back and start all over again.

I want to ask—ask you—you all this question, all of you. The notion that most of you at least have indicated that a system has to be validated in order to be valid if you're going to judge people. And you can't judge people on the basis of subjective criteria. Now, employees all get evaluated now. Are the systems by which employees get evaluated now valid? How do you explain that? Do they use any subjective criteria?

Mr. RIDLEY. I would say, much too often, they clearly are not. And that is based on years of experience doing this.

One quick thing about—in terms of my colleague who noticed that they are subjective, this is one of the things that I call manager/supervisor learning disabilities. That if it is really all that subjective, why do we go through the time trying to do what Delegate Norton is talking about? If it is all subjective as we just said, then we just said, we don't need all these systems. The fact of the matter is, is that subjectivity and objectivity are matters of degree. And what you want to do is curtail the subjectivity; increase the objectivity. And how do you do that? You dial up to get as much

clarity as you can so at the very least you have a shared understanding of what is expected concretely from the supervisor. And I say that your report must be written well, and you say, what does that mean? I will be specific with you. I would mean that the right content must be in there. If it is not, that is a problem. I would suggest it needs to be well organized. If it is all over the place, that is a problem. If there is a problem with format, spelling—you need to be specific. And my point here—and I'll let this go—is that we can do these things. We can do them well. But any time you engage in a false dichotomy in terms of something being either subjective or objective, you get no place. It's a matter of degrees.

Ms. NORTON. I want to get to whether or not we can do them so easily if we just kind of do them well.

Mr. TOBIAS. I think you're using—

Ms. NORTON. I'm really looking for the answer to my question about what is it that keeps the present system from being attacked? Now, in his testimony—in his testimony, Mr. Stier correctly says Title V recognizes that incentives and recognition for excellence are appropriate. Then he says but the current 1949 era general service system does not reward high performance. It rewards above all else longevity. Well, he is right. Why does it do that, gentlemen? Why didn't it start out doing exactly what Mr. Stier wanted to do? That is the point I'm trying to get somebody to speak to since it is obvious that if you can do it other than by time and service or the like, that you'd expect the Federal Government to go to that system.

Mr. Tobias.

Mr. TOBIAS. I think that you're using the term validated as a term of art. And as a term of art, there is no performance evaluation system in the Federal Government today that has been validated as you're using that term. With respect to the issue of longevity, in many agencies, within grade increases have been equated with longevity. That is not the intent of the statute. And if the statute were incremented properly, performance would be an integral part of whether or not people receive within-grade increases or not.

However, to get back to your original point, there is no performance evaluation system in the Federal Government that has been validated as you're using that term.

Ms. NORTON. Well, I believe that is the honest answer, and I believe there is a reason for it. And if you want to be helpful to us, you can help us get to the point where you could set up a performance-based pay or any other system—obviously you have a system which, confronting the difficulty of finding and identifying objective criteria, default on that and go to an overall system that is not inherently unfair but is not the best system. It says at least if an employee lasts long enough and is satisfactory, then that employee ought to receive an increment in pay. And essentially what you are confronting and what you especially, Mr. Stier, are avoiding, is that it is the difficulty, some would say, in a system of 3 million employees, perhaps impossibility, of coming up with a system that would meet validation standards that sends the Federal Government to broader standards, to avoid just the kind of litigation that we have

already seen at the SEC, the same kind of results we've seen at the GAO.

So that if there are short cuts to what the Supreme Court has made the public and private sector do in order to implement systems of pay or any other term and condition of employment since the late 1960's, if there are short cuts, it is—that is what we're looking for. If there are not short cuts, then we need to tell the Federal Government the truth. We need to send the Federal Government to AT&T, who got sued in a nationwide class action suit, and say how did you, in fact, finally get out of the consent decree? And then AT&T will tell the OPM we did so first by saying a lot of back pay and second by validating everything in this place, and it cost us billions of dollars. I don't think you do us any service by saying that the Federal Government, which paid the private sector to do that and has made other Federal agencies do that, can now implement the same kind of system on its own without going through the same rigorous process and adding in the additional step that will be required because it is a Civil Service system. If you mitigate the difficulty, then you invite SEC-type overturns and a lot of waste of the taxpayers' money.

And, Mr. Chairman, I must say that I think, if not before the end of this year, but quickly, as soon as we can, we have to find a way to roll back the pay-for-performance so that we do not subject ourselves to inevitable litigation, lose Federal employees at the height of when we're trying to keep them, at the height of when we can't compete with the private sector on many grounds. This has been a real lose-lose for us. And if you want to sit down with any of us who have been in touch with this work for a long time, I am open to seeing if there are ways—some of the broadbanding ways have some—some suggestions within them.

What I'm not open to is saying to the Federal Government on the part of this subcommittee, go ahead, try it out; if you get sued, you've got a lot of lawyers, let them take care of it.

Mr. STIER. Congresswoman Norton, I'd love to take you up on the offer.

Ms. NORTON. I'd be glad to meet with you.

Mr. STIER. Thank you.

Mr. DAVIS OF ILLINOIS. Thank you very much, Delegate Norton.

Mr. Tobias, you noted that you collaborated with the Partnership for Public Service on a study that found that Federal employees are not motivated to increase their performance solely because of monetary rewards. Federal employees are motivated to increase their performance when they are effectively led and their skills are matched to the agency's mission. Despite having access to the same information, you and Mr. Stier have reached two different conclusions. You suggest that it is highly unlikely that the IRS can successfully implement a pay-for-performance system. Mr. Stier suggests moving forward with these systems.

If Federal agencies have already shown not to seek employee buy-in and have difficulty linking agency mission with measurable standards, is it fair to continue to allow Federal employees to labor under these systems?

Mr. TOBIAS. Well, I think the risk, Mr. Chairman, of a failed pay-for-performance system is what is shown in the data from the IRS,

and that is, rather than motivating, morale drops and people perform at a lower level than they would with a pay-for-performance system. I think that is the real risk of a malimplemented, maldesigned, maladministered pay-for-performance system. I think it is a significant risk, and the IRS hasn't gotten over the hump based on their own survey data.

Mr. DAVIS OF ILLINOIS. Both you and Mr. Stier recommend closer involvement and oversight of these systems by Congress. You note that the Controller General deserves congressional committee jurisdiction to hold oversight hearings on each of the major agencies once a year. The subcommittee has not taken no for an answer, but agencies have been reluctant to testify before this subcommittee on these issues and have ignored our recommendations and findings. This includes the GAO and one of today's witnesses. This leaves the subcommittee with no choice but to legislate to effect change which can be long and difficult. Given these facts, is it reasonable to expect Congress to assist with and examine every agency's pay-for-performance to ensure that they are fair and equitable, credible and transparent and have the support of agency employees?

Mr. TOBIAS. I think if the—if the data were developed by the agency, I think it would be rather easy for Congress to determine whether the goals and objectives are being achieved. IRS had stated goals. The data showed that the goals weren't being achieved. It—it is not a complex matter to measure the effectiveness based on what employee surveys say and whether or not the organizational goals and objectives are being achieved. I think it is more that Congress is interested in performance and performance results. And that is really the thrust of my testimony. I believe that it takes the interest of Congress, the dedicated time of a President and the support of political appointees to really have a performance management—an effective performance management system. And as I said in my testimony, I believe that the implementation of an effective performance management system with the corollary of a better led work force would have a significant, positive impact on performance in the Federal Government.

Mr. DAVIS OF ILLINOIS. Thank you.

Dr. Fay, a senior management analyst with DNI wrote in a November 12, 2007, commentary for the Federal Times that pay-for-performance suffers from two false assumptions: First is that what is the best for business must be best for government; and the second is that pay-for-performance will be effective for the entirety of a work force as diverse as the Civil Service. What are your views on this analyst's assessment?

Mr. FAY. I would agree that what is good in the private sector is not necessarily appropriate for the public sector. I think both sectors have an interest in improving performance of the work force, and I think they might need to go about it in different ways. With respect to your second question, could you repeat that, please? The second question.

Mr. DAVIS OF ILLINOIS. I think it was only one, and that is your assessment of the analyst's—

Mr. FAY. Well, his second point.

Mr. DAVIS OF ILLINOIS. Let's see. His second point, I believe—oh, his second is that pay-for-performance will be effective for the entirety of a work force as diverse—

Mr. FAY. Generally, I think that is probably true. That is, the same system would be—the kind of system you use with one job family is likely to be different from that used with another. And as I recall, the rationale that was developed by the agencies and accepted by OPM for each unit having its own performance management system, performance appraisal system was that there were two diverse set of needs across agencies for one system to cover everybody. And my reading of the DOD system was that is probably true of DOD as well, having a single system with some subsets to cover all the civilian employees of DOD strikes me that it is unlikely that it is going to be highly workable.

Again, in the private sector what works best is a system that is customized to each employee's job. As I said, the EEO rulings of the past suggest that any criterion measure, any performance measure that is not based on job-specific information is of necessity biased and illegal.

Mr. DAVIS OF ILLINOIS. Thank you very much.

And Mr. Phillips, let me thank you for joining us. Let me ask you, what can the IRS do to improve the effectiveness of its pay-for-performance system?

Mr. PHILLIPS. Thank you, Chairman Davis.

My name is Mike Phillips, and I'm the deputy inspector general for audit for TIGDA. And—well, we've heard some of the same themes here today. The IRS took its system of 11 grades for front-line managers in 2005 and converted it to an 11 pay band system for its frontline managers. The problem was they could not reach consensus—senior management could not reach consensus in terms of—because of the variety of—of positions—of which positions—and how large the band should be.

So what we would recommend is to look to consolidate their bands from 11 to a smaller number to move more toward the flexibility and the opportunities for managers in those different pay bands to diversify their knowledge as well as their experience and also present them greater opportunities to advance their careers within those individual pay bands.

We also felt like—feel that those managers who are receiving at least a fully satisfactory or a net or higher assessment—performance assessment should receive at least the salary raise that is equivalent to the across-the-board adjustment that is given to all nonmanagerial IRS employees under the GS based system.

And then, finally, for those truly exceptional and outstanding managers, we feel like that the IRS needs to work with the Office of Personnel Management to look for additional flexibilities to provide appropriate salary increases that would maybe even take those managers above the pay band that they are in to recognize their performance.

Mr. DAVIS OF ILLINOIS. Well, let me ask you, do you have any concerns about the IRS's decision to hire a contractor to evaluate the IRS's pay-for-performance system?

Mr. PHILLIPS. Yes, Chairman Davis. The IRS has worked with a third-party contractor to—to do a three-phased assessment of its

pay-for-performance system over a 5-year period. And we really feel that is too long a period for making any significant changes to the system. Particularly at this point in time, as Mr. George mentioned, the IRS is faced, like all other Federal agencies, with a tremendous wave of retirements at its executive and managerial ranks over the next few years. So we really feel that it needs to shorten the amount of time that it is going to take to assess the system.

Mr. DAVIS OF ILLINOIS. Did your audit examine the impact of the IRS's pay-for-performance system on minorities and older workers?

Mr. PHILLIPS. No, sir. We do not look at those aspects.

Mr. DAVIS OF ILLINOIS. Would you recommend that such a study be conducted?

Mr. PHILLIPS. We are planning, as the IRS continues to implement its system, to do further study in that area, and we would take that certainly under consideration.

Mr. DAVIS OF ILLINOIS. Thank you very much.

And let me thank all of the witnesses for the hearing this afternoon. We thank you for your insight as well as for your patience and thank you indeed. You're excused.

And we'll seat our second panel. While our witnesses are being seated, I'll go ahead and introduce them. We have Mr. Diego Ruiz, who is the Executive Director of the Securities and Exchange Commission. For 10 years, Mr. Ruiz served as a business executive with Univision Communications, Inc., a leading Spanish language media company. In January 2006, Mr. Ruiz left Univision to serve at the Federal Communications Commission in Washington, DC, as Deputy Chief of the Office of Strategic Planning and Policy Analysis.

Mr. Richard Spires is the Deputy Commissioner for Operational Support at the Internal Revenue Service. He is responsible for overseeing the development of policy for IRS Personnel Services, Technology and Security. Mr. Spires previously served as the IRS's Chief Information Officer.

Dr. Ronald Sanders is Associate Director of the National Intelligence for Human Capital.

And I believe that constitutes our panel. Gentlemen, it is our custom that all witnesses be sworn in. So if you will stand and raise your right hands.

[Witnesses sworn.]

Mr. DAVIS OF ILLINOIS. The record will show that the witnesses answered in the affirmative. And, gentlemen, we're delighted that you're here. Of course, the drill is that the green light indicates that you have 5 minutes in which to summarize your statement, which is already included in the record. The yellow light indicates that the time is running out. Of course, the red light indicates that it is time to stop.

So we thank you very much, and we'll begin with Mr. Ruiz.

STATEMENTS OF DIEGO RUIZ, EXECUTIVE DIRECTOR, SECURITIES AND EXCHANGE COMMISSION; RICHARD A. SPIRES, DEPUTY COMMISSIONER FOR OPERATIONAL SUPPORT, INTERNAL REVENUE SERVICE; AND RONALD P. SANDERS, CHIEF HUMAN CAPITAL OFFICER, OFFICE OF THE DIRECTOR OF NATIONAL INTELLIGENCE

STATEMENT OF DIEGO RUIZ

Mr. RUIZ. Thank you, Mr. Chairman. I appreciate the opportunity to appear before you today to discuss the SEC's pay-for-performance system. The SEC is phasing in a new pay-for-performance system that was developed in cooperation with the National Treasury Employees Union, which we believe will provide meaningful rewards to employees for strong performance and will facilitate the accomplishment of the SEC's statutory mission to protect investors, promote capital formation and foster market efficiency.

In response to chronic difficulties by the SEC in recruiting and retaining mission critical staff, in December 2001, Congress passed the Pay Parity Act which authorized the SEC to increase its pay and benefits to levels comparable to those of other financial regulatory agencies while adhering to merit system principles. The SEC, with the support of OMB, obtained additional funding to implement a new compensation system that would improve base pay while increasing accountability by linking pay increases to individual performance.

In early 2002, after the development of the new compensation and pay-for-performance systems, the SEC and the NTEU entered into compensation negotiations but were unable to reach agreement over several issues. Subsequently, the matter was submitted to Federal Services Impasse Panel, and in November 2002, the FSIP issued a decision and order that supported the SEC's arguments and the substance of the SEC's proposal, including that the SEC's compensation proposal was the product of extensive research carefully tailored to meet the specific needs of the SEC and the comparability and the overall fairness were established. The FSIP order allowed the agency to provide an annual merit increase based on individual performance. In the same year that the SEC obtained pay parity, the SEC's mission was expanded by the enactment of the Sarbanes-Oxley Act. The additional responsibilities and the requirements of the act demanded a corresponding increase in the SEC's mission critical staff.

The SEC's then relatively new compensation system proved its effectiveness by allowing the SEC to increase staffing by a third in less than 12 months. In addition, in the time since the compensation system was established, attrition rates have fallen dramatically to as low as 6 percent, which at that time was a 10-year low for the SEC and well below governmentwide averages.

As part of the SEC's continuous re-assessment and refinement of the pay-for-performance system, in May 2003, the SEC adopted our current two-tiered management system to assess individual performance, which can be rated either acceptable or unacceptable based on several agency-wide success factors. To link performance with compensation, only employees who receive an acceptable as-

assessment are eligible for, although not guaranteed, a merit increase.

After the first merit pay cycle in 2003, the NTEU filed a grievance against the merit pay process alleging that it discriminated against employees in several protected classes. Although the arbitrator ruled that the statistical evidence concerning the commission's compensation system in 2003 supported a finding of impact discrimination for two classes of employees, the arbitrator's ruling made clear there was no evidence of any intentional discrimination on part of the commission or any of its employees.

The administrator did not make a ruling on the appropriate remedy and has asked that the parties present briefs on how to resolve the issue. The briefs have been submitted to the arbitrator, and briefing on all issues should be complete this month. We await the arbitrator's decision.

Even before the arbitrator's ruling, the SEC had identified a number of areas where the two-tiered system could be improved. Thus, in September 2006, the commission established the Performance and Accountability Branch within the Office of Human Resources, which is leading the implementation of a new five-tiered performance management program for the commission that will help establish unambiguous criteria from which fair, credible and transparent rating and merit increase decisions can be made.

The new five-tier program is designed specifically for the commission's unique business needs. A joint labor management team comprised of senior human resources staff and NTEU officials is working collaboratively on our transition to this program. This transition began in September 2006 with a pilot program involving all SEC Office of Human Resources personnel. Following significant adjustments based on lessons learned from the pilot program and feedback from SEC managers and supervisors, the commission's management is now being transitioned into the new system. We anticipate transitioning the rest of the commission beginning in 2009. The commission is purposely taking its time in starting with leadership to allow them to become comfortable with a new process before being required to manage subordinates on it. Also, the commission has decided to temporarily separate our performance management system from the merit-based system until the new performance management system is completely implemented. This will allow the agency to focus all its efforts on effectively implementing all aspects of the new system before relying on it to provide performance information to support paid decisions. During the transition to the five-tier system, all employees receiving an acceptable performance rating will receive an equivalent share of the funds the agency has available for merit-pay increases. The new performance management program was developed based on best practices both from other Federal agencies and the private sector. Additionally, it responds to several performance-related recommendations from the GAO and OPM.

Finally, the new program addresses issues raised by the SEC's own Office of the Inspector General. To underscore the SEC's resolve to improve continuously in this area, the Inspector General has agreed to perform another full audit of the performance management program in 2 years. Thank you for providing me the op-

portunity to update you on the SEC's pay-for-performance system,
and I would be happy to address any questions you may have.
[The prepared statement of Mr. Ruiz follows:]

Testimony of

**Diego Ruiz
Executive Director
U.S. Securities and Exchange Commission**

**Before the
Subcommittee on Federal Workforce, Postal Service, and the District of Columbia,
Committee on Oversight and Government Reform**

U.S. House of Representatives

February 12, 2008

Chairman Davis, Congressman Marchant, and members of the Subcommittee:

Thank you for the opportunity to appear before you today to provide you with background and related issues concerning the SEC's pay-for-performance system. The SEC is in the midst of phasing-in a new pay-for-performance system that was developed in cooperation with the National Treasury Employees Union (NTEU). The SEC believes that this new system will provide meaningful rewards to employees for strong performance, and will facilitate the accomplishment of the SEC's statutory mission to protect investors, promote capital formation, and foster market efficiency.

In order for the Committee to put into proper context the SEC's pay-for-performance system, first let me briefly outline its evolution, including: (1) the circumstances that led to the SEC's decision to seek pay parity; (2) the September 4, 2007 arbitration decision; and (3) where, in light of that decision, the SEC stands as we move forward with pay-for-performance supported by a revised performance management program.

Establishing Pay Parity

Prior to 2002, the SEC experienced significant difficulties recruiting and retaining mission critical staff. These difficulties, in part, were due to disparities between SEC salaries and those of other financial regulatory agencies as well as between the SEC and the private sector. These difficulties are well documented in reports and testimony previously presented to Congress.

In response, the SEC employed compensation programs such as recruitment bonuses, retention allowances, performance cash awards, and special pay rates. However, these programs did not go far enough to help us attract the talent needed nor did they significantly reduce the Commission's attrition rates.

In response to this chronic problem, in December 2001, Congress passed the Investors and Capital Markets Fee Relief Act (Pay Parity Act). The Pay Parity Act authorized the SEC to increase its pay and benefits to levels comparable to those of other financial regulatory agencies

while adhering to merit system principles. The SEC, with the support of the Office of Management and Budget (OMB), obtained additional funding to implement a new compensation system that would improve base pay while increasing accountability by linking pay increases to individual performance. As a result of the legislation, the SEC transitioned from the General Schedule to a compensation system consisting of 17 pay grades with up to 31 steps in each grade, which helped to maintain the flexibility needed in compensating a wide variety of professional and support staff within the agency.

Negotiations with the NTEU

In early 2002, after the development of the new compensation and pay-for-performance systems, the SEC and the NTEU entered into compensation negotiations but were unable to reach agreement. The parties disagreed over several aspects of compensation including how employees would be converted into the new pay structure and the type of pay-for-performance system that would be implemented. Subsequently, the matter was submitted to the Federal Service Impasses Panel (FSIP), and in November 2002, the FSIP issued a Decision and Order that supported the SEC's arguments and the substance of the SEC's proposal, concluding that the SEC's compensation proposal was the "product of extensive research carefully tailored to meet the specific needs of the SEC" and that comparability and overall fairness were established. (*Securities and Exchange Commission and National Treasury Employees Union*, 02 F.S.I.P. 122 (2002)).

Among other requirements, the FSIP Order allowed the agency to provide an annual merit increase based on individual performance, and stated there shall be no automatic within-grade increases. Further, the Order stipulated that to be eligible for a merit increase, an employee must meet an acceptable level of performance based on standardized factors developed and tailored for each office and division in the agency.

The overall results of the Panel's 2002 order proved to be quite positive. While no compensation system is perfect, the system was effective in improving recruitment and reducing attrition while enhancing overall organizational effectiveness.

Sarbanes-Oxley Act of 2002

In the same year that the SEC obtained pay parity, the SEC's mission was expanded by the enactment of the Sarbanes-Oxley Act (SOx). SOx mandates a number of reforms to enhance corporate responsibility and financial disclosures, and combat corporate and accounting fraud. It directed the SEC to review all public company disclosures on a specified "regular and systematic basis for the public investor." It also created the Public Company Accounting Oversight Board (PCAOB), to oversee the activities of the auditing profession, and charged the SEC with oversight of the PCAOB.

The additional responsibilities and requirements of the Act demanded a corresponding increase in the SEC's mission critical staff. The SEC's relatively new compensation system proved its effectiveness by allowing the SEC to increase staffing by a third in less than twelve months in order to administer the Act. Furthermore, since the current compensation system was

established by the Panel's Order, attrition rates dramatically fell to around 6 percent, which was a ten-year low for the SEC and well below government-wide averages.

Two-Tiered Performance Management System

As part of the SEC's continuous reassessment and refinement of the pay-for-performance system, in May 2003 the SEC issued a performance management policy to: (1) establish fair and equitable performance expectations and goals tied to improving organizational effectiveness in accomplishing the SEC's mission and goals; (2) encourage and facilitate communication between supervisors and employees; (3) effectively evaluate employee performance, identifying strengths and weaknesses; and (4) provide a mechanism to address effectively any deficient performance.

The two-tiered management system called for an overall assessment of individual performance, which would be rated either "Acceptable" or "Unacceptable" based on performance in several critical elements that were standard across the SEC and based on identified agency Success Factors.

To link performance with compensation, the process allowed for five different levels of performance to be recognized, and only employees who receive an "Acceptable" assessment would be eligible for – although not guaranteed – a merit increase. Employees receiving an "Acceptable" assessment would receive either 0, 1, 2 or 3 merit steps depending on a determination by management of appropriateness.

In developing this system, the SEC solicited employee concerns through studies, employee surveys, and employee focus groups. Our efforts were informed by the results of these SEC sponsored assessments as well as assessments of SEC and other federal agencies such as the Office of Personnel Management (OPM), the Government Accountability Office (GAO), and OMB.

September 2007 Arbitration Decision

After the first merit pay cycle in 2003, the NTEU filed a grievance against the merit pay process alleging that it discriminated against employees in several protected classes. The Commission received the arbitrator's decision in this case on September 4, 2007. Although the Arbitrator ruled that the statistical evidence concerning the Commission's compensation system in 2003 supported a finding of impact discrimination in two of those classes – black employees in pay grades 8 to 16 and employees age 40 and over – the arbitrator's ruling made clear that there was no evidence of any intentional discrimination on the part of the Commission or any of its employees.

The arbitrator did not make a ruling on the appropriate remedy, and asked that the parties present briefs on how to resolve the issue. The briefs have been submitted to the arbitrator and briefing on all issues should be complete this month. We await the arbitrator's decision. Without waiving our rights as to the arbitrator's liability finding, the Commission has filed a brief that proposes a remedy that would make whole affected employees consistent with the Commission's commitment to a pay-for-performance system. The Commission's brief proposes that, for all employees in the two impacted classes, the Commission would individually

reconsider the merit pay awards for 2003 with a goal of more fully rewarding employee contributions to the Commission's mission. Retroactive pay adjustments would be made to employees who receive upgraded awards. The NTEU would be provided a summary of the pay adjustments, and individual employees who remain dissatisfied would be permitted to file grievances in accordance with the collective bargaining agreement. We continue to work through this legal process.

Five-Tiered Performance Management Program

Even before the arbitrator's ruling, the SEC had identified a number of areas where the two-tiered system could be improved. A hallmark of SEC management's approach in this area has been continual review and reassessment to correct any shortcomings that have been identified. The SEC remains committed to improvement in both its pay-for-performance system and performance management program, and is in the process of building on our experience with revisions designed to strengthen the agency's ability to assess individual and team performance.

In September 2006, the Commission established the Performance and Accountability Branch within the Office of Human Resources (OHR). This branch is charged with further improving the performance management process while strengthening the link between performance and compensation.

Currently, this branch is leading the implementation of a new, five-tiered performance management program for the Commission that will help establish unambiguous criteria from which fair, credible, and transparent rating and merit increase decisions can be made. The five-tiered program replaces the system that was the subject of the arbitration dispute. The five-tiered program is essential for making meaningful distinctions in performance among our employees, and responds to concerns for a more equitable system. It was designed specifically for the Commission's unique business needs by SEC subject-matter experts and a consulting firm widely recognized as leading in the areas of performance management and measures. A joint Labor-Management Team comprised of senior OHR staff and NTEU officials is working collaboratively on our transition to this new program.

This program moves the Commission away from standardized performance elements to more individualized performance objectives and competencies, and will require supervisors to make meaningful distinctions in performance on a 5-tier scale.

This is a distinct departure from the current "pass/fail" system, and a change that will require a significant cultural shift within the Commission. Consequently, the SEC is deliberately phasing in the transition so as to allow time for adjustments that will ensure the program supports the strategic needs of the various offices and divisions.

The transition began in September 2006, with a pilot program involving all SEC OHR personnel. OHR personnel began using all new performance plans in October 2006 and completed the first annual assessment under the new program in October 2007. This was in keeping with the commitment from OHR to live with any new system for at least one year before transitioning the rest of the Commission.

Following significant adjustments based on lessons learned from the OHR pilot program and feedback from SEC managers and supervisors, the Commission's management is now being transitioned into the new system. Training begins later this month with a goal of having SEC leaders on the new program by October 1, 2008. The Commission is purposefully taking its time and starting with leadership to allow them to become comfortable with the new process before being required to manage subordinates on it. We anticipate transitioning the rest of the Commission beginning in 2009. Also the Commission has decided to temporarily separate our performance management system from the merit pay system until the new performance management system is completely implemented. This will allow the Commission to focus all of its efforts on effectively implementing all aspects of the new system before relying on it to provide performance information to support pay decisions. During this interim period, all employees receiving an "Acceptable" performance rating will receive an equivalent share of the funds the agency has available for merit pay increases.

The new performance management program was developed based on best practices both from other federal agencies and the private sector. Additionally, it responds to several performance-related recommendations from the GAO and OPM. Finally, the new program addresses issues raised by the SEC's own Office of Inspector General (OIG). To underscore the SEC's resolve to improve continuously in this area, the OIG has agreed to perform another full audit of the performance management program in two years.

Thank you for providing me the opportunity to update you on the SEC's pay-for-performance system, I would be happy to address any questions you may have.

Mr. DAVIS OF ILLINOIS. Thank you very much. Mr. Spires.

STATEMENT OF RICHARD A. SPIRES

Mr. SPIRES. Thank you, Chairman Davis.

I'm pleased to be here today to discuss the Internal Revenue Service's efforts to implement pay-for-performance and respond to questions from the subcommittee. This is an important issue as the Federal Government continues to look at ways to recruit and retain talented managers. While I've worked at the IRS in various capacities since 2004, I've spent more than 20 years in private industry where pay-for-performance is commonplace and, from the perspective of the companies with which I was associated, has had great success.

I recognize that there is not a perfect correlation between government and private enterprise and what works in one may not in the other. And in my 4-year tenure at the IRS, I've seen some of the reasons why. However, the development of a strong pool of talented employees is such a critical issue for any enterprise; it is important that innovative programs be attempted.

In many respects, the IRS has been at the forefront of the pay-for-performance program in the Federal Government. We've been dealing with it for over 7 years as we've implemented such a system for our more than 7,000 managers. Though there have been some bumps along the way, the creation of pay bands and compensating employees for the quality of their work rather than their tenure with the agency has helped the IRS respond to the challenges presented in turning the agency into a modern and more efficient organization.

My written statement lays out much of the background of how we got into pay-for-performance and describes in some detail how we implemented the program and discusses some of the obstacles we faced.

I want to focus my remarks this afternoon on two things. First, I want to outline the areas in which pay-for-performance has benefited our agency. Second, I want to offer some of the lessons we've learned so that the agencies that follow us can benefit from our experiences and have an easier transition.

Perhaps the greatest benefit of pay-for-performance for the IRS has been the opportunities afforded to us in implementing the dramatic overhaul of the agency mandated by the IRS Restructuring and Reform Act of 1998. Specifically, the implementation of a new performance management system allowed us to link manager performance to the functional goals of the organization. Managers and their supervisors jointly developed specific performance commitments as part of an annual performance plan that are designed to further the goals of the functional unit and the IRS. The pay flexibilities have enabled the IRS to strengthen the linkage between manager performance and the overall IRS goals.

Despite these benefits, the road has not always been smooth and without controversy. Let me offer several lessons we've learned and, frankly, are still learning that may benefit other agencies in the Federal Government. First, agencies should move deliberately and cautiously to implement the program that is right for their organization, recognizing that any change in the way employees are

paid will raise concerns on their part. Second, communication is critical. Employees must understand how the program will work and how they will be affected. There also must be forums that have their questions answered. Third, an effective performance evaluation system must be in place. Employees must understand the basis for their evaluation, and there should be a review system in place to make sure evaluations are being made on a consistent and fair basis. Fourth, supervisors and employees must be trained properly on how to use the system and make sound evaluations. Fifth, ongoing program evaluation is essential to ensure that the pay-for-performance system is operating as intended, and agencies must be willing to modify and revise to meet the changing needs of their organization. And finally, evaluations must be made free of any discrimination based on race, gender, age or national origin.

I'm proud to say that an overall evaluation of our program by a third party contractor found that, since fiscal year 2004, there has been no disparate impact on any group of our managers. The contractor analyzed the trends of the ratings data grouped by race, gender, age and national origin. In each group, ratings trended in a similar path to the average ratings across all groups.

Thank you, again, Mr. Chairman, for the opportunity to be here. And I'll be happy to respond to any questions.

[The prepared statement of Mr. Spires follows:]

**WRITTEN TESTIMONY OF
RICHARD A. SPIRES
DEPUTY COMMISSIONER, OPERATIONS SUPPORT
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT
REFORM
SUBCOMMITTEE ON THE
FEDERAL WORKFORCE, POSTAL SERVICE AND THE
DISTRICT OF COLUMBIA
ON
IMPLEMENTATION OF PAY FOR PERFORMANCE**

FEBRUARY 12, 2008

Good afternoon Chairman Davis, Ranking Member Marchant, and Members of the Subcommittee. My name is Richard Spires and I am the Deputy Commissioner for Operations Support of the Internal Revenue Service. I am pleased to be here today to discuss IRS' efforts to implement pay for performance and respond to questions from the Subcommittee.

The IRS is not new to the pay for performance issue. We have been dealing with it for over seven years as we have tried to move deliberately to implement such a system for our more than 7,000 managers. Though there have been some bumps along the way, the creation of paybands and compensating employees for the quality of their work rather than their longevity with the agency has helped the IRS respond to the challenges presented in turning the agency into a modern and more efficient, 21st century organization.

What I would like to do today is offer you some background on how we got into pay for performance, discuss a report issued by the Treasury Inspector General for Tax Administration (TIGTA) and how we responded to their recommendations, stress the importance of performing evaluations in a fair, non-discriminatory manner, and finally offer some observations on what our seven years of experience has taught us about implementing pay for performance.

Background

In 1998, Congress passed the IRS Restructuring and Reorganization Act (RRA-98). As the name of the new law indicates, RRA-98 totally transformed the IRS and changed dramatically the way that we did business.

For example, prior to enactment of the RRA-98, IRS was organized geographically with leadership organizations and decision-making by managers dispersed across the country. After enactment, however, we reorganized along functional lines to support the different taxpayer segments – Wage and Investment, Small Business/Self-Employed, Large and Mid-Sized Businesses, and Tax Exempt/Government Entities – with much of the senior leadership based at the IRS headquarters located in Washington.

Recognizing the dramatic shift that this and other changes included in RRA-98 required and the potential impact on the tens of thousands of employees that might be affected, the Congress included personnel flexibility provisions that authorized the Secretary of the Treasury to establish one or more paybanding systems covering all or any portion of the IRS workforce under the General Schedule (GS) pay system, subject to guidance to be issued by the Office of Personnel Management (OPM). Accordingly, OPM prescribed criteria for IRS paybanding systems that followed the principles included in RRA-98 in December 2000.

In providing this flexibility, Congress recognized that the IRS needed the ability to recruit and retain high-quality leadership to transform the Service into what Congress envisioned when it enacted RRA-98 – an efficient, modern, and responsive organization designed around the needs of taxpayers. Accordingly, IRS would have the flexibility to design its salary and incentive structures to support mission accomplishment, base pay decisions on performance rather than length of service, and implement a new Performance Management System that was aligned to organizational performance.

Program Implementation

We implemented the first payband in March 2001. It was for Senior Managers (SM) and it consolidated Grades 14 and 15 in the GS schedule into a single 10-step payband which had salaries ranging from the equivalent of a GS-14 Step 1 through a GS-15 Step 10. Under this new system, Senior Managers continued to receive their basic pay, including locality pay, similar to that provided to GS employees. However, the entitlement to step increases that were previously available under the GS system was removed. Employees were eligible every two years for a performance based increase, and progressed to the next step within the payband only if their performance ratings met or exceeded certain performance standards.

A similar payband structure was implemented in November 2001 for the new IRS campus functions including Accounts Management, Submission Processing, and Compliance. This payband for Department Managers (DM) incorporated salary grades GS-11 through GS-13 into a single 16-step payband.

Implementation of the flexibilities afforded was critical in successfully carrying out the mandates of RRA-98 from two critical perspectives.

First, implementation of the new Performance Management System allowed us to link manager performance to the functional goals of the organization. Managers and their

supervisors would develop specific goals and objectives designed to further the goals of the functional unit and the IRS. The manager could then be evaluated at the end of the year based on his or her success in meeting the agreed to goals.

Second, implementation of the paybands helped us realign Senior Management positions as the organization shifted from a decentralized, geographic based hierarchy to an organization where leadership was based on functional needs. It also helped realign Department Managers in our campus functions.

Former IRS Commissioner Everson decided to continue expansion of pay for performance in line with the President's Management Agenda. In September 2005, the IRS implemented a Frontline Manager (FM) payband using the same criteria as for the Senior Manager and Department Managers – the Office of Personnel Management criteria from 2000. Beginning in 2002, the IRS had an independent contractor conduct multiple evaluations of the SM and DM paybands. The results of these evaluations and feedback from Executives and SM and DM employees afforded the IRS the opportunity to incorporate modifications to the design of the FM payband.

Unlike the SM and DM paybands, the FM payband consisted of 11 single-grade bands (GS 5 through 15) with open-rate ranges of pay (no steps) that are the same as the GS Pay System for the correlating grade. Also unlike the original paybands, Frontline Managers are eligible for a performance based increases to their salary each year. The performance based increase replaces the GS Pay System within-grade step increases, quality step increases, and annual across-the-board pay adjustments.

Effective March 2006, the SM and DM paybands were modified to incorporate a stepless design (range of rates) and an annual review, just like the FM payband. However, SM and DM paybands remained multi-grade paybands. For example, the SM payband has a minimum rate of GS-14 Step 1 and a maximum rate of GS-15 Step 10. Only the 10 steps within this range that were established when the program was originally designed were eliminated. Similarly, the DM payband ranged from GS-11 Step 1 to GS-13 Step 10 and the 16 steps were removed. All managers continue to receive the GS locality pay for where they work.

TIGTA Report and IRS Response

In July 2007 the Treasury Inspector General for Tax Administration (TIGTA) published a report entitled *The Internal Revenue Pay-for-Performance System May Not Support Initiatives to Recruit, Retain, and Motivate Future Leaders* (Ref. Number 2007-10-106).

The overall objective of this review was to determine whether the IRS pay for performance system effectively links compensation to individual performance. The report analyzed the implementation of the IRS pay for performance program, more specifically implementation of the FM payband, and made four specific recommendations for program improvement.

The first recommendation concerned the fact that the payband system for Frontline Managers essentially retained the GS Schedule pay system and only removed the incremental steps within each grade. The single grade band structure was implemented to meet the diverse needs of the IRS workforce and mission; and recognized the wide variety of occupations and grades that were difficult to group into common levels of work. And while the creation of broad occupational paybands has some obvious benefits, this allowed the focus to shift to performance based pay, and preserve the current classification framework until other occupations are banded.

The second recommendation related to the fact that the IRS Commissioner retains the authority to determine the level of pay increases for managers, and TIGTA recommended that the IRS Commissioner guarantee a salary increase to those managers who are rated as having "Met" performance expectation. Specifically, the fear was that the Commissioner could determine not to provide an increase to managers who were classified as having "Met" performance expectations. This would mean such a manager could end up with less of an increase than a comparably situated employee under the GS system. This in turn could possibly act as a disincentive for individuals to move into management slots.

While in theory, the IRS Commissioner could withhold such an increase, since the inception of the IRS paybands in 2001, the Commissioner has never done so. Those managers with a "Met" performance expectation have received a performance based increase that was the same as the increase provided to all GS employees.

The third recommendation was that the IRS should consider alternative sources of funding for the performance based salary pools and ensure amounts dedicated for increases are sufficient to both reward top performers and compensate other managers equitably, based on their performance.

Finally, TIGTA recommended the Chief Human Capital Officer should offer employees an opportunity to express concerns and questions about the new pay system directly to Human Capital Office experts. TIGTA further recommended that there be an effort to communicate more openly and timely with employees before implementing any new changes to the employee's compensation and benefits.

The IRS takes seriously the TIGTA recommendations. We have already implemented one of the recommendations by improving communications with affected managers. Late last year, we completed a strategic communication framework. As part of this we partnered with management associations such as the Federal Managers Association and the Professional Managers Association as well as our internal stakeholders on communications relating to performance based increases and other aspects of pay for performance. Through this partnership, specific communications were developed to address questions surrounding performance based increases and shared with all managers. Last year managers expressed frustration and discontent that they were not informed until October 2006 that a "Met" rating would receive an increase equivalent to the GS. Consequently, this year managers were informed in June that managers with a "Met" performance rating would receive a performance based increase equivalent to the

GS. We continue to update our Payband Resource Center for Managers (website) as information becomes available, and posted the performance based increased values, updated salary calculator, and other frequently asked questions relative to these issues.

We also agreed with two other recommendations. In fact, prior to the TIGTA audit we had already initiated a third-party evaluation of the IRS Pay for Performance System in its entirety, including an assessment of the Frontline Manager payband and a review of the performance-based salary pools. Since the IRS just implemented the FM payband in 2005, and redesigned the SM and DM in 2006, the IRS has just completed its second performance based increase and now can begin to evaluate trends. That evaluation is being conducted in three phases over a five year period, and will determine whether, and how strongly, our current pay-for-performance system supports our human capital organizational goals to recruit, retain, and motivate future leaders. We are also considering the TIGTA recommendation for modifying the IRS FM pay systems.

The one recommendation that we did not agree with was the one that would inappropriately reduce the authority of the IRS Commissioner and guarantee a salary increase to those managers that were rated as having "Met" expectations. As I indicated earlier, the Commissioner has always approved a standard increase for those that are rated as having "Met" expectations.

Performing Evaluations Fairly

IRS has approximately 7,200 permanent managers. Of this total, approximately 5,300 are permanent Frontline Managers; 1,500 are permanent Senior Managers; and 350 are permanent Department Managers. During filing season, the IRS may have an additional 1,000+ temporary managers.

To maintain credibility in the performance management evaluation process, it is important that performance evaluations be done in a fair, non-discriminatory manner. IRS is committed to that.

The performance evaluation process really begins a year in advance when managers meet with their supervisors to discuss their goals for the year and how they plan to meet those goals. They meet again mid-way through the year to discuss progress toward those goals. Finally at the end of the year, the supervisor meets again with the manager and rates him or her based on one of five levels of performance: Outstanding, Exceeded, Met, or Minimally Satisfactory or Not Met.

In an effort to further monitor the performance evaluation process and to insure objectivity and consistency, the initial evaluation of a supervisor will be reviewed by a Performance Review Board (PRB). It is the policy of the IRS that annually each division/function will review the summary evaluation ratings of their managers on a corporate basis. Each PRB ensures ratings consistently reflect similar performance across work unit lines, and validates that the ratings support individual and organizational performance.

Within the IRS, performance based increases as well as bonus parameters are consistent across all functional units. That means that a manager within our Wage and Investment Division who is rated as “Outstanding” will receive the same performance increase as a manager in our Small Business division with an identical rating. Managers across all functional units with the same rating will receive the same performance based increase. Each functional unit has discretion to determine the specific performance bonus amount; however, the overall performance bonus parameters are applied across functional units.

Accordingly, the performance based increases for Outstanding will always be greater than for someone who was rated as “Exceeded,” which in turn will be higher than someone rated as “Met.” Someone who was rated “Not Met” would not receive any increase.

A similar system exists for bonuses. A manager receiving an “Outstanding” summary evaluation will receive a bonus. Someone who exceeds *may* receive a bonus and someone who is rated as “Met” would only receive a bonus under extraordinary circumstances.

It is also important that evaluations be made free of any discrimination based on race, gender or national origin. We asked the third party contractor that is conducting the overall evaluation of the entire program to look at this issue and offer its assessment. The contractor has reported that it has completed its preliminary analysis of the ratings data and found that since Fiscal Year 2004, there has been no disparate impact on any group of employees in the Senior Manager (SM), Department Manager (DM), or Frontline Manager (FM) paybands. The contractor analyzed the trends of the ratings data grouped by gender, age (Over 40 and Under 40) and ethnicity. In each group, ratings trended in a similar path to the average ratings across all groups. As part of their more detailed analysis, the contractor will also analyze the same data across business units, Mission Critical Occupations and individual paybands.

Lessons Learned

As the interest in pay for performance escalates across the Federal government, the IRS finds itself in the unique position of having information to share. We have certainly gained experience along the way, made adjustments to our system, and are still learning as we go. We will continually assess and reassess all aspects of our pay for performance system and refine it to support the mission and goals of the IRS.

However, based on our seven years of experience with our own program, we can offer some suggestions that might prove useful to agencies that might pursue paybanding or pay for performance in the future.

Specifically, we have found first-hand that a successful pay-for-performance system must incorporate the following key elements:

- Agencies should move deliberately and cautiously to implement the program that is “right” for its organization;
- Communication is critical. Managers must understand how the program will work and how they will be affected. There also must be forums to have their concerns and questions answered;
- An effective performance evaluation system must be in place. Managers must understand the basis for their evaluation and there should be a review system in place to make sure evaluations are being made on a consistent basis;
- Supervisors/managers must be trained properly on how to use the system and make sound evaluations; and
- On-going program evaluation is essential to ensure that the pay for performance system is operating as intended. Agencies must be willing to modify and revise its system to meet the changing needs of the organization.

Summary

We have found that a properly implemented pay-for-performance plan can have obvious positive benefits for any agency. Perhaps most important of these is the fact that employees are rewarded for the quality of their work and not the tenure in their job. But perhaps equally important is the fact that such a system necessitates that managers at all levels are forced to interact in such a way that they discuss the agencies goals and how their individual performance relates to those goals.

As I indicated at the beginning, we tried to move deliberately in terms of implementing pay-for-performance, but we still faced numerous bumps in the road. However, the benefits far outweigh the problems. It has helped us make the organizational transition required by RRA-98 and link compensation to performance.

Thank you again, Mr. Chairman for the opportunity to be here and I am happy to respond to any questions.

Mr. DAVIS OF ILLINOIS. Thank you very much, Dr. Sanders.

STATEMENT OF RONALD P. SANDERS

Mr. SANDERS. Thank you, Mr. Chairman.

It is good to be back. Thank you for the invitation to testify at today's hearing. Specifically I understand that the subcommittee is interested in learning more about our plans for designing, developing and implementing a more modern compensation system for civilian employees in the U.S. Intelligence Community—I'm sorry. I've got it now.

Of interest to these proceedings, we do have a few IC elements that are covered by Title V of the U.S. Code to include analytic functions in the Departments of Energy, State and Treasury. Unfortunately, I'm unable to share any details of that proposed system with the subcommittee at this time. We're still very much in a predecisional phase. In this regard, the most salient features and likely those that are of most interest to the subcommittee remain under deliberation and discussion amongst the six Cabinet Departments and seven agencies and elements that comprise the IC, with the various IC directives that will enable and establish the system's framework still in formal interagency coordination.

As you may know, Section 308 of H.R. 2082, the Intelligence Authorization Act for Fiscal 2008, require the Office of the Director of National Intelligence to submit a report of the IC's pay modernization initiative. And although that bill is not yet law, we fully intend to comply with the congressional wishes. We'd be glad to provide your subcommittee a copy of that report as soon as it has been submitted to the Intelligence Oversight Committees on the Hill.

What I can discuss with the subcommittee today is a related initiative now proved to establish common performance management requirements for the IC civilian work force. Those requirements are set by an IC directive issued by Director McConnell last November, and I'd be pleased to do so. Also I can discuss one of our legislative proposals from last year that did not make it into H.R. 2082 but may be of some interest to the subcommittee given your focus today.

First, our performance and management directive. The DNI believes strongly that a common set of core performance management policies are an essential requirement for the IC as a way of strengthening the community. In the past, performance appraisal systems varied widely across the IC, and they did not consistently reinforce the common behaviors and values which are critical to the modern Intelligence profession, such as collaboration and critical thinking.

To remedy this, the DNI's 100-day plan called for the completion of a directive of establishing performance management requirements for the IC civilian work force. That directive does not establish a common system. Instead it establishes common core requirements and processes for managing the performance of IC employees that are to be incorporated into the performance systems established and administered by the 16 separate IC elements and their 6 parent Cabinet Departments.

Employees will be evaluated on what they achieve, their results, performance objectives developed jointly between manager and employee, and in the manner in which those results were achieved. How, their manner of performance, with the latter focusing on six common performance elements, which by the way have been validated. They include such transformational competencies such as critical thinking, collaboration, personal leadership and integrity and technical expertise. These go to the heart of Intelligence reform.

This performance management directive does not cover our senior executive or equivalent senior level positions. They'll soon be covered by a similar policy. All departments and agencies in the IC are to implement the directive not later than October 1, 2008 for application in the 2009 appraisal cycle. I would note here that the implementation of the ICD does not require any special or unique statutory authority. It can be implemented as is by all IC elements, including those covered by Title V. I'd also note that the directive is a necessary antecedent of a modern performance-based compensation system; although it is a separate and critical strategic human capital initiative in its own right. For example, the IC deems common performance management requirements are essential to the success of our Civilian Joint Duty Program. They also provide a mechanism to reward and reinforce our core IC values, as well as some of the transformational behaviors I mentioned before.

Let me turn now quickly to a related legislative proposal. As part of the administration's fiscal 2008 Intelligence Authorization request, we asked Congress to give the DNI the ability to extend already authorized personnel flexibilities from one IC agency to another; this in order to maintain a level playing field across the community. In short, we wanted to be able to share the myriad special personnel flexibilities, for example, deployment incentives, foreign language incentive pay, various scholarship authorities, etc., that have been authorized for one or more but not all of our agencies by Congress over the years. And in the longer term, we wanted to allow our smaller IC elements, those covered by Title V, to be able to take advantage of our new pay-for-performance system.

As you know, there is no direct legal authority for those elements for Title V employees to be covered by that new system, and we're concerned that, as the rest of the community moves to a system over the next few years that is more performance-based and market-sensitive, our smaller elements may be placed at a competitive disadvantage. To remedy this, we propose that the DNI, with the concurrence of the head of the department or agency, could authorize adoption of a flexibility already granted to another IC element. But those IC elements with employees covered by Title V, the director of OPM would also have a say. Although this was included in the Senate Intelligence Authorization, it was not included in the conference report, nor has that conference report become law. We're now in the process of developing our legislative proposals for the 2009 Intelligence Authorization. Thus I must add that, while we again requesting this provision, it has not yet cleared the Office of Management and Budget.

Thank you very much, Mr. Chairman. I'll look forward to answering your questions.
[The prepared statement of Mr. Sanders follows:]

STATEMENT OF DR. RONALD P. SANDERS
ASSOCIATE DIRECTOR OF NATIONAL INTELLIGENCE FOR HUMAN CAPITAL

HEARING BEFORE THE SUBCOMMITTEE ON THE FEDERAL WORKFORCE, POSTAL
SERVICE, AND THE DISTRICT OF COLUMBIA
HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
FEBRUARY 12, 2008

Good morning. Chairman Davis and Congressman Marchant, thank you for the invitation to testify at today's hearing on implementing modern pay practices in the federal government. Specifically, I understand that the Subcommittee is interested in learning more about our plans for designing, developing, and implementing a more modern compensation system for civilian employees in the US Intelligence Community (IC). Of interest to these proceedings, we do have a few IC elements that are covered by title 5, United States Code, to include analytic functions in the Departments of Energy, State, and the Treasury.

The new compensation system we are developing is intended to be far more performance-based and market-sensitive than the Federal Government's General Schedule system. We are undertaking this challenging initiative to reinforce and reward excellence; to create a "level playing field" across the Intelligence Community, in order to avoid harmful competition for talent; and to create and foster a common culture of collaboration and high performance.

Unfortunately I am unable to share any details of that proposed system with the Subcommittee at this time. We are still in a pre-decisional phase – similar to where the Departments of Defense and Homeland Security were prior to publishing their proposed implementing regulations in the *Federal Register* for public comment. In this regard, the most salient features (and likely those of most interest to the Subcommittee) remain under deliberation and discussion amongst the six cabinet departments and 17 agencies and elements that comprise the IC, with the various IC Directives that will enable and establish the system's framework still in formal interagency coordination.

As you may know, Section 308 of H.R. 2082, the proposed Intelligence Authorization Act for Fiscal Year 2008, would require the Office of the Director of National Intelligence (DNI) to submit a report on the IC's pay modernization initiative, and although that bill is not yet law, we fully intend to comply with the Congressional wishes. We would be glad to provide your Subcommittee a copy of that report as soon as it has been submitted to the intelligence oversight committees.

What I can discuss with the Subcommittee today is a related initiative, now approved, to establish common performance management requirements for the IC civilian workforce; those requirements are set by an IC Directive issued by Director of National Intelligence (DNI) McConnell last November, and I would be pleased to do so. Also, I can discuss one of our legislative proposals from last year that did not make it into H.R. 2082 but may be of some interest to the Subcommittee, given your focus today.

A Modern Performance Management System

The DNI believes strongly that a common set of core performance management policies are an essential requirement for the IC...as a way of strengthening the *Community*. In the past, performance appraisal systems varied widely across the IC, and they did not reinforce the common behaviors and values which are critical to the intelligence profession, such as collaboration and critical thinking. To remedy this, the DNI's 100-Day Plan for Integration and Collaboration directed the completion of Intelligence Community Directive 651, *Performance Management System Requirements for the Intelligence Community Civilian Workforce*.

This Directive establishes common, core requirements and processes for managing the performance of IC employees that are to be incorporated into the performance management systems established and administered by the separate IC elements and/or their parent departments. Employees will be evaluated on results ("what" they achieved) and in the manner by which they achieved those results ("how" they were accomplished), with the latter focusing on six common performance elements – including such critical competencies as critical thinking, collaboration, personal leadership and integrity, technical expertise. – that are at the heart of intelligence reform. This performance management Directive does not cover those IC senior executive or equivalent senior-level positions, but they will be covered by a similar directive.

All departments and independent agencies with IC employees are to implement the Directive by not later than October 1, 2008, for application to the Fiscal Year (FY) 2009 performance cycle. I

would note here that implementation of ICD 651 does not require any special or unique statutory authority; it can be implemented “as is” by all IC elements, including those covered by title 5.

I would also note that while ICD 651 is a necessary antecedent of a modern, performance-based compensation system, the Directive was a separate strategic human capital initiative in its own right. For example, the ICD's common performance management requirements are essential to the success of our Civilian Joint Duty Program; they also provide a mechanism to reward and reinforce our core IC values, as well as the several critical behaviors I mentioned previously.

FY 2008 Legislative Proposal

Let me now turn to a related legislative proposal. As part of the Administration's FY 2008 Intelligence Authorization request, we asked Congress to give the DNI the ability to extend already-authorized personnel flexibilities from one IC agency to another, this in order to maintain a “level playing field” across the IC. In the short term, we wanted to be able to “share” the myriad of special personnel flexibilities (for example, deployment incentives, foreign language incentive pay, various scholarship authorities, etc.) that have been authorized for one or more (but not all) agencies over years. And in the longer term we wanted to allow those smaller intelligence elements with employees covered by title 5 to be able to take advantage of our new pay system.

As you know, there is no direct legal authority for those IC elements with title 5 employees to be covered by our new pay system, and we are concerned that as the rest of the IC moves to a

system over the next several years that is more performance-based and market-sensitive, our smaller IC elements may be placed at a competitive disadvantage.

To remedy this, we proposed that the DNI, with the concurrence of the head of the department or independent agency, could authorize the “adoption” of an authority that had already been authorized for any other IC element. For those IC elements with employees covered by title 5, the Director of the Office of Personnel Management would also have a say. Although this was included in the Senate Intelligence Authorization, it was not included in the conference bill. The Administration continues to support inclusion of this flexibility in the final bill.

Thank you very much; I look forward to answering your questions.

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Mr. DAVIS OF ILLINOIS. Thank you very much, Dr. Sanders.

Mr. Ruiz, let me begin with you. In retrospect, do you—do you think it was prudent for the SEC to implement a pay-for-performance system without buy-in from the National Treasury Employees Union?

Mr. RUIZ. Thank you, Mr. Chairman. As I stated in my testimony, the circumstances around the time of our setting up the pay-for-performance system that we are currently under were unique in the life of the agency. We were undergoing a number of years of pretty significant attrition, having a hard time remaining competitive with other Federal regulators and retaining staff. And we received from the Congress additional funding to be able to increase pay for our staff to be more competitive with other areas of the government. So we were operating under the significant constraints and operating under a fairly accelerated schedule at the time. We take very seriously any concerns that—the concerns that have been raised about the 2003 merit pay cycle. And as I noted, we're in the process of discussing the remedy phase of that arbitration decision with the arbitrator and with NTEU.

Mr. DAVIS OF ILLINOIS. Let me see if I'm understanding. Are you saying that, given a different set of circumstances, where some of the pressures that you were experiencing in the agency at that time, if those were not present, then you would find employee buy-in to be desirable, a desirable part?

Mr. RUIZ. Absolutely. I think it is. At the end of the day, any performance management system is meant to improve the quality of the work force and the caliber of the work being performed by the agency, and I don't think that is doable in any meaningful way unless the entire team, both management and employees, has clear objectives; there is a commonality in terms of the goals for the agency. And so I think it is a very important component of any successful pay-for-performance system that—any performance management system period, that there be significant commonality of objectives among those staff.

Mr. DAVIS OF ILLINOIS. While the arbitrator found no evidence of intentional discrimination on the part of the SEC, hundreds of minorities and older workers were adversely impacted by the system. How does the SEC intend to make the affected employees whole or to rectify that situation?

Mr. RUIZ. Let me just say, Mr. Chairman, that the case is still going through the arbitration process. And so I have to be careful of exactly what I say about it so as not to prejudge the manner. But as you've stated, the arbitrator did not find any evidence of intentional discrimination, but there—statistically—a statistical—regarding the disparate impact. We've submitted briefs to the arbitrator. He has asked the SEC to do so as well, specifically regarding the remedy—and we're awaiting for the arbitrator's decision on that.

Mr. DAVIS OF ILLINOIS. Now, the arbitrator's decision applies only to the first merit based cycle in 2003. The National Treasury's Employee Union has filed grievances against the merit pay system for 2004, 2005, 2006 and etc. Has the SEC made any attempt to settle with the union regarding the subsequent years this problematic pay-for-performance system has been in place?

Mr. RUIZ. Mr. Chairman, we've been in discussions with the union concerning the 2003 case, including discussions and that—seeing if there are grounds for settlement on that. In the subsequent years, 2004 and beyond, I do not believe we have engaged in those discussions. And again, this is simply because we're still going through the process of the 2003 merit cycle arbitration decision. And I believe it is not yet—the issue is not yet right to gather the lessons we can draw from the 2003 cycle and apply it to those other years. But we certainly, I think, have a good working relationship with our union and have been engaged in discussions throughout this process and are open to further discussions in the future, certainly.

Mr. DAVIS OF ILLINOIS. I note that instead of denying the SEC employees a COLA, that the SEC can deny its employees an automatic within-grade increase. Could you explain for the committee what an automatic within-grade increase is and whether or not an employee who meets expectations can be denied such an increase?

Mr. RUIZ. I am sorry, Mr. Chairman, I didn't hear the beginning of your question. I didn't quite make it out. Could you state it again?

Mr. DAVIS OF ILLINOIS. Instead of denying a COLA, that the SEC can deny employees an automatic within-grade increase. And I am trying to find out what is an automatic within-grade increase, and whether or not an employee who meets expectations can be denied such an increase.

Mr. RUIZ. Under our current system, Mr. Chairman, we have basically a two-tier performance process. An employee can be classified either as acceptable or unacceptable, which, I think, was referred to in the earlier panel as essentially pass/fail. So employees that are rated at the unacceptable level are not eligible for a merit pay increase. They do receive the full COLA, as does the rest of the Federal Government.

If an employee is classified at the acceptable level, again, under the current system that we are under, they can be given a range of steps in merit pay increases each year. And, of course, we are an appropriated agency, and so this is subject to what our level of funding is for the year.

So the decision on whether or not an employee receives a merit pay increase, again, I am talking about merit pay above and beyond the COLA, is dependent on that unacceptable rating.

I should say, just by way of context, in this past performance cycle, I don't believe that we have had any unacceptable ratings.

Mr. DAVIS OF ILLINOIS. But it is considered merit pay, and if a determination is made that the employee does not merit this, for all practical purposes, bonus, that it can be denied them?

Mr. RUIZ. The merit pay component, yes, that is correct.

Mr. DAVIS OF ILLINOIS. Thank you very much.

Mr. SPIRES, let me ask you, can you explain how budgetary constraints prohibit the IRS from establishing a policy providing mandatory minimum increase in salary, which is equivalent to an across-the-board adjustment?

Mr. SPIRES. The statute RRA 98 delegated decisions regarding those increases of COLA to—I believe, the Secretary of the Treasury would then delegate it to the IRS Commissioner. We have

made a decision that we would not mandate that, that we would live by that statute.

However, the practical application is that since we have implemented a pay-for-performance system in the IRS for managers 7 years ago, we have always granted that COLA increase for all managers that are fully successfully rated or above.

Mr. DAVIS OF ILLINOIS. Do you believe that the IRS pay-for-performance system is actually providing an incentive to managers, given that employees who are rated fully satisfactory receive both step increases and the across-the-board-adjustment, while managers who are rated fully satisfactory are assured of neither?

Mr. SPIRES. I believe, Mr. Chairman, that our pay-for-performance system, while certainly not perfect, is helping the organization meet its overall objectives. We did have some bumps in the road, and I allude back to my testimony where I talk about the fact, and TIGTA alluded to this, we didn't communicate and train the management staff as well as we needed to on the system. And I think that's led to some of the kinds of employee satisfaction ratings that Dr. Tobias stated on the previous panel.

That being said, time-specific objectives to each manager in their performance plan that roll up to that organization's overall goals and objectives, that then roll up to the overall IRS mission, I think, has really helped us in overall performance. If you look at the overall performance of the IRS over the last 5 years, in almost every category we measure, we have performed markedly better, in taxpayer service, in our compliance function.

In our modernization, compliance, for instance, from 2002 to 2007, we increased our enforcement revenues more than 70 percent in an era of essentially flat budgets, and we have 10,000 employees less than we had then.

I think that speaks to good management, and I believe that a pay-for-performance system—and echoing what Dr. Tobias said, a good performance management system are keys to have made that happen.

Mr. DAVIS OF ILLINOIS. Let me ask, has the IRS made a decision on whether to implement a pay-for-performance system for the rest of the approximately 900,000 employees?

Mr. SPIRES. Sir, we have not. We—as I said earlier, it's not perfect. We do believe we need more time to get it right for the management ranks. We are still assessing whether it makes sense to engage with the NTEU and discussions regarding doing it for non-managerial employers. We have not made any decision yet as to whether we are going to move forward.

Mr. DAVIS OF ILLINOIS. Recognizing that there is some decrease in morale among some managers within the agencies, and employees that might be considering managerial positions, what is the IRS doing to try and beef that up or to have cut it off?

Mr. SPIRES. Well, we recognize that there may be a perception of a disincentive, if you will, for nonmanagerial employees to move into the managerial ranks. We are studying that right now, sir. This goes well beyond pay-for-performance issues, but given the pay compression that you see in the Federal Government pay scale, what can we do to incentivize those that really have the capability to manage, to move into the management ranks?

I personally believe, and I think it's bearing out in the IRS, that the pay-for-performance system does not need to be a disincentive. I think with the kinds of studying we are doing regarding ours, the training we are doing, the education, I believe we can move past that. But there are other disincentives. Particularly in the IRS, we have issues around mobility. Many times we ask those going into management ranks to actually relocate, given the disparate nature of the IRS and our function. There are just issues like that also loom large in trying to get employees interested in becoming managers.

Mr. DAVIS OF ILLINOIS. Can you tell me what the critical pay authority is?

Mr. SPIRES. Sure. As part of the enactment of RRA 98, the IRS was given the authority to hire up to 40 individuals meant to come out of the private sector into the executive ranks in order to help the IRS bring best practices, appropriate best practices, from the private sector into the government, and it was more pay flexibility, although none of the critical pay executives can earn more than the Vice President of the United States.

Mr. DAVIS OF ILLINOIS. Have you been able to evaluate that to determine what it is that the IRS might have been able to accomplish with this authority and with these individuals that it was not able to accomplish without them?

Mr. SPIRES. Well, you are right in my wheelhouse, sir, because I am one of those critical pay executives.

Most of them, about 75 percent, and I believe we have about 25 on board right now, although I am not sure of the exact number, most of them are in our information technology organization, our IT organization.

Most of them were brought in because they brought in specific skills where we felt we were lacking in the IRS, in information technology, management in particular, and I believe that it has been a major benefit to the organization. We have great individuals in our IT organization that are career people, but there's a new set of technologies, a new set of disciplines that they weren't familiar with. By being able to bring in people from the private sector with those skills for a 4-year period, I think, has been a very big help in moving our whole modernization program along on the IT side.

Mr. DAVIS OF ILLINOIS. Thank you very much.

Dr. Sanders, let me ask you, you testified that you cannot provide any details on the DNI's proposed pay-for-performance system because it is in a predecisional phase.

Could you explain what the predecisional phase means?

Mr. SANDERS. Certainly, Mr. Chairman.

When you began the hearing, you talked about the pay-for-performance system that the Director of National Intelligence wants to impose on the Intelligence Community.

Mr. Chairman, the DNI does not have the statutory authority to do that. Instead, we must achieve agreement amongst the 16 intelligence agencies and elements and their six parent Cabinet departments, who have six different personnel systems in different titles of the U.S. Code.

Again, only a very small minority of our employees are covered by Title V. The rest are Title X and Title XV and other parts of

the law. So given that the DNI cannot impose this system on them, we must achieve agreement amongst them.

Literally 2 years from last week, then principal Director of National Intelligence, General Mike Hayden, commissioned a feasibility study to look at whether we could and should develop a common compensation framework for the Intelligence Community. This was one of the critical recommendations made by the President's Commission on the Intelligence Capabilities of the United States with regard to weapons of mass destruction—let me take a deep breath—other wise known as the Silverman-Robb Commission, and they viewed it and we view it as an essential way of trying to glue this community together, 6 departments, 16 agencies, all with different chains of command.

And one of the things I lose sleep over, Mr. Chairman, is different pay and other personnel practices across that community. If we have those kinds of disparities, there will be no community, and we won't be able to achieve the purposes of the Intelligence Reform Act.

Mr. DAVIS OF ILLINOIS. Now, let me make sure, because I understand that this Thursday the Director of the DNI, Mike McConnell, is scheduled to testify before an open Senate Select Intelligence hearing on DNI's authorities and personnel issues. Will Mr. McConnell provide the Select Intelligence Committee with details of its pay-for-performance proposal, or do you know?

Mr. SANDERS. No, again, Mr. Chairman, he is in no different situation than I am. The directives that we are developing over those 16 agencies and 6 departments are, in effect, treaties. We need everyone's agreement to move forward in a common way. We don't have that agreement yet. We have been at this for 2 years. This is very much an event-driven process, and the first and most critical event is to try to reach some consensus amongst the intelligence agencies and elements to proceed forward in a common way.

Mr. DAVIS OF ILLINOIS. The administration—the fiscal year 2008 budget contained funds to increase diversity in the Intelligence Community. Each year the DNI reports to the House Permanent Select Committee on Intelligence on diversity in six of the largest intelligence components.

In fiscal year 2006, the DNI reported that the IC was 21 percent minority compared with 37 percent of the overall population, and 39 percent women compared with 51 percent of the overall population. DNI has acknowledged that the Intelligence Community needs to make progress on diversity.

Given the adverse impact pay-for-performance systems seem to have on minorities and older workers, how can you assure the subcommittee that the DNI system will be any different?

Mr. SANDERS. Let me respond in a couple of ways. First, we are in the process of completing our fiscal 2007 report on EEO and diversity in the Intelligence Community, and I am not sure it has been submitted to our oversight committees, but, as it is, as we do so, you will see that we have made modest progress.

We have made modest progress each year for the last 3 years in almost every category; for example, recruiting and promotion rates. The percentages exceed our representation rates. So while admittedly our representation rate is below, for example, the civilian

labor force, the fact is that we are hiring at a greater rate than our current representation rate for women and minorities. So we are making modest progress. That's progress we don't want to retrench in that regard. We need a work force that looks like America and, frankly, to be able to deal with all the diverse peoples of the world.

It's a very high priority of Director McConnell's. We would not be moving forward with pay for performance if we thought for one instant that it would have adverse impact. Pay-for-performance systems are not inherently discriminatory.

Frankly, I agree completely with Congresswoman Norton on the notion of trying to set up a validated system so that behaviors you are rewarding people on are, in fact, resident in the work that they do. We have spent a lot of money and a lot of time engaging hundreds of our employees, our best subject matter experts, to develop the performance elements that I talked about earlier, collaboration, critical thinking and the like, as well as performance standards, specific behavioral definitions of what those look like.

I would just like to add, my colleague on the previous panel who seemed to scoff at the notion of evaluating employees on collaboration—Mr. Chairman, you know this—the 9/11 Commission said one of the causes of that tragedy was that we had not collaborated and shared information across the Intelligence Community.

We have 16 agencies and stovepipes and 6 Cabinet departments. If we don't put it in our performance evaluation system, and we don't validate it, and we don't reinforce those kinds of behaviors, we won't improve, and our improvement is a matter of national security.

So we are not going to—we are not going to shortcut this. We have spent the money to validate our elements and our standards. We have oversight built into our proposed rules. We have training built into our proposed rules, not just general training for managers and supervisors and how to administer the system, but we are going to include specifically training on how to guard against implicit bias, subconscious bias.

So we have standards that are validated. We have oversight mechanisms, literally five levels of oversight from the first level of supervisor all the way up to a body called the IC Human Capital Board that will look for and guard against unlawful discrimination. In fact, the charter board specifically says, among other things, it will guard against unlawful discrimination.

So we have accountability, we have transparency, we have oversight, we have the standards, we have the training to make sure that we don't have any adverse impact on women and minorities. Our goals there have been too hard won to risk them.

Mr. DAVIS OF ILLINOIS. Thank you.

The last question I think I have is given the statutory authority you are seeking for civilian personnel changes fall within Title V of this subcommittee's jurisdiction, when do you intend to brief the members of this subcommittee on the pay provisions of your proposal, and do you have a timeline for each phase of your pay-for-performance proposal?

Mr. SANDERS. I am happy to brief you, your colleagues and your staff as soon as we get past the predecisional stage. I can tell you, Mr. Chairman, no one in this room more than I do wants to get

past that predecisional stage. This has been 2 years in the making. It is event-driven and time-phased. This would literally be implemented through fiscal 2012.

So we want to do this right. It will start with a single agency and proceed in gradually expanding phases until the entire Intelligence Community is covered.

Mr. Chairman, we want to make sure you are on board, because one of the things I worry about—and we do need your committee's indulgence on this—at some point we have to be able to extend the system to our Title V agencies. In relative terms they are very small, they are vulnerable to interagency competition, and we don't want to leave them behind. So we are going to have to brief you; we are going to have to get you on board; we are going to have to convince you that this pay system won't work, that we have learned from lots of other mistakes, including many I have made myself, so that we can get it right the first time and then, with your permission, be able to extend it to our smaller elements so they are literally not cherry-picked as they move forward.

Mr. DAVIS OF ILLINOIS. Well, I have no more questions.

I want to thank you gentlemen very much for your testimony and for your patience. You are excused.

Thank you very much.

Mr. DAVIS OF ILLINOIS. While we are seating our third and last panel, I will go ahead with the introductions. We are pleased to have Ms. Colleen Kelley. She is the president of the National Treasury Employees Union [NTEU], the Nation's largest independent Federal-sector union, representing employees in 31 different government agencies. As the union's top elected official, she leads NTEU's efforts to achieve the dignity and respect Federal employees deserve.

Ms. Kelley represents NTEU before Federal agencies and the media and testifies before Congress on issues of importance to NTEU members and Federal employees.

Mr. John Gage is the national president of the American Federation of Government Employees [AFGE], of the AFL-CIO. Mr. Gage watches over the rights of some 600,000 Federal and D.C. Government employees. Mr. Gage was elected national president at AFGE's 2003 national convention in Las Vegas, Nevada.

Mr. Gregory Junemann was unanimously selected to serve as president of the International Federation of Professional and Technical Engineers [IFPTE], AFL-CIO, at the union's 54th convention in March 2001.

On Tuesday, May 8th, the IFPTE filed a petition to hold an election at the Government Accountability Office. On September 19, 2007, GAO analysts voted overwhelmingly to join the International Federation of Professional and Technical Engineers [IFPTE]. The vote was 897 to 485, a 2 to 1 margin in favor of IFPTE representation for 1,800-plus analysts at the Government Accountability Office.

Ms. Carol Bonosaro is president of the Senior Executives Association [SEA], the professional association representing the top career executives in the Federal Government. Ms. Bonosaro was, herself, a senior executive until her retirement from Federal service in 1986 to become SEA's full-time president.

Let me thank all of you for being here, for your patience, your indulgence, and, of course, as is tradition with this committee, all witnesses are asked to be sworn in. So if you would stand and raise your right hands.

[Witnesses sworn.]

Mr. DAVIS OF ILLINOIS. The record will show that the witnesses answered in the affirmative.

Again, thank you all very much for being here with us, and we will begin with you, Ms. Kelley.

STATEMENTS OF COLLEEN KELLEY, PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION; JOHN GAGE, PRESIDENT, AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES; GREGORY JUNEMANN, PRESIDENT, INTERNATIONAL FEDERATION OF PROFESSIONAL AND TECHNICAL ENGINEERS; AND CAROL BONOSARO, PRESIDENT, SENIOR EXECUTIVES ASSOCIATION

STATEMENT OF COLLEEN KELLEY

Ms. KELLEY. Thank you very much, Chairman Davis. I appreciate the invitation and the opportunity to speak with you today. This distinguished subcommittee has heard testimony today from Federal agency heads and renowned experts from academia. I am here today to present the viewpoint of the tens of thousands of dedicated public servants who are currently on the ground working in the government. These Federal employees are the ones for whom alternative pay systems are a looming reality, not just an abstract concept.

The President's fiscal year 2009 budget submission reaffirmed a commitment to replace the current GS system with a "modern classification, pay, and performance management system that is both results-driven and market-based."

OPM just released its December 2007 report on performance-based pay systems in Federal agencies touting their success in leading to a better government. I am here to refute that.

No. 1, the notion that the GS system needs to be replaced is not true; and, two, that current pay-for-performance systems have shown widespread success. To the contrary, NTEU's experience shows that the alternative pay systems at many of the agencies in the OPM report are characterized by a slew of grievances, arbitrations, litigation, high attrition rates and rock-bottom employee morale.

Nothing in this OPM report or any other government study I have found presents data documenting the need to eliminate the GS system. The GS system is market-based. It has the goal of achieving comparability with the private sector through 32 different locality pay areas, and employees receive raises based on merit, which is synonymous with performance and achieving results.

The GS system is transparent. It has rules, standards and evaluations which must be written. If managers currently have trouble with the GS system it does not make sense to go to a more subjective pay system.

The Transportation Security Administration's past pay system is a prime example of failure. Employees are constantly tested, but if they fail, they are not told what they did wrong. The training is minimal, and a majority of airport screeners don't know what is expected to get a pay raise. The uncertainty impasse has resulted in the highest attrition rate in the government. The TSA past system should be eliminated, and legislation should be enacted to put TSA screeners onto the GS pay system.

NTEU strongly believes that in the absence of a statutorily defined pay system like the GS system, pay should be subjective to collective bargaining as it is in the private sector. At the SEC and FDIC, NTEU bargains for pay on behalf of its employees, yet problems still exist.

These alternative pay systems must be seen as fair, as credible and as transparent. Employees must know what their work expectations are and what they need to do to improve. Unfortunately, the SEC has failed on all accounts.

In September 2007, as you know, NTEU won an important legal battle when an arbitrator ruled for the union and for employees that SEC's implementation of its 2003 pay-for-performance system was illegal. This faulty system was found to be discriminatory against African American employees above grade 8 and employees aged 40 and older.

The SEC system used a set of vague and subjective what they call agency success factors to determine whether and how much of a merit increase an employee would receive. The generic factors were not linked to employees' job duties, and they applied to every position within the SEC. They were based on amorphous criteria.

NTEU warned the SEC that employees would not know how to satisfy the vague standards, and that arbitrary treatment would occur. This was compounded by a lack of training and guidance for managers.

As you noted, four additional grievances are pending, yet the SEC continues to determine pay increases based on the flawed system currently in place.

FDIC's pay system, too, was problematic. The system had established a separate set of what they call corporate contributions. These factors were used to determine an employee pay raise increase, which generated a great deal of resentment and did little to motivate employees to foster teamwork. So to its credit, however, working with NTEU, the FDIC has agreed to suspend its pay-for-performance system, hiring employees for the 2007 performance cycle. However, IRS managers have not embraced their pay-banding system. In their public comments on OPM's regs, the Federal Managers Association spoke against these forced pay quotas.

In conclusion, I would like to emphasize a few things. There is no hard evidence that the current pay system for Federal employees needs to be changed. The current experiments with alternative pay systems are failing, and, most importantly, pay systems must be fair, credible and transparent to be successful.

Thank you for the opportunity again, Mr. Chairman, and I would be happy to answer any questions.

Mr. DAVIS OF ILLINOIS. Thank you very much.

[The prepared statement of Ms. Kelley follows:]



Testimony of

Colleen M. Kelley

National President

National Treasury Employees Union

Before the

Subcommittee on Federal Workforce, Postal Service and
The District of Columbia

Oversight and Government Reform Committee
House of Representatives

on

Robbing Mary to Pay Peter and Paul:

The Administration's Pay for Performance System

February 12, 2008

Chairman Davis, Ranking Member Marchant, and members of the Subcommittee, I appreciate the opportunity to appear again before this distinguished subcommittee to discuss the important subject of federal pay systems. As you know, the National Treasury Employees Union represents more than 150,000 federal employees in over 30 different agencies and departments throughout the government.

The subcommittee will hear today from a number of distinguished witnesses representing both the Administration and academia. I am here to present the viewpoint of the tens of thousands of dedicated public servants who are currently on the ground working in government. These federal employees are the potential recipients of the various pay experiments being pushed by this administration. They are the ones who help administer our government systems; defend our homeland; process and administer our programs such as social security; support our states and cities; and help regulate and inspect everything from our food supply, to financial institutions. These federal employees want what every other employee wants, a system that offers fair compensation for a fair day of quality work.

In July, I testified before this subcommittee on the many shortcomings of the Administration's so-called pay for performance systems. Unfortunately, despite the growing evidence that these systems lack credibility, the Administration continues its attempts to dismantle the current GS system and replace it with various performance management systems. Just last week, the President's FY 2009 budget submission to Congress reaffirmed its commitment to pay-for-performance alternative systems to "replace the current General Schedule pay system with a modern classification, pay, and performance management system that is both results-driven and market-based." (*p. 1097 FY 2009 Budget Appendix*)

While this is indeed nice sounding rhetoric, make no mistake about it – The GS system is market-based. It has the goal of achieving comparability with the private sector through 32 different locality pay areas. And employees receive raises based on merit, which is synonymous with performance and achieving results. As the distinguished professor and witness today, Dr. Charles Fay has pointed out in the past, the Bureau of Labor Statistics uses "impeccable methodology" to gather and evaluate statistically valid data for the GS system. (May 22, 2007 testimony)

Further, the General Schedule is a structured system. It has rules, standards and evaluations which must be written. Yet we see a pattern of managers unable to follow the rules and work within the GS system. If managers currently have trouble with the GS system, it does not make sense to go to a *more subjective* system. That will not solve anything, and my testimony will point to several failed cases of alternative pay systems.

OPM Report: Alternative Personnel Systems

Several weeks ago, OPM released its report entitled *Alternative Personnel Systems in the Federal Government: A Status Report on Demonstration Projects and Other Performance-based pay Systems* (December 2007). While OPM proudly touted this report as evidence as of success, a close reading shows a patchwork of pay systems across government that cannot collectively, or individually, be characterized as successful. If anything, the report demonstrates how inconsistent, arbitrary and problematic the differing pay systems are throughout the

government. While the report lists a hodgepodge of systems at various stages of their development, and includes a number of surveys, it lacks hard data on the parameters of the surveys and the numbers of people who participated in them. Simply stating percentage of employee satisfaction or non-satisfaction, without the necessary information on the numbers of people polled, and the exact questions asked, makes the conclusions questionable.

In its Executive Summary, OPM itself refers to “trends and observations” from these pay systems. It then goes on to tout sweeping successes—everything from strong links between pay and performance, to better managing by supervisors, to recruitment and retention benefits to cost-containment in payrolls. This is a gigantic leap of logic. NTEU has extensive front line experience with alternative pay systems at many of the agencies in the OPM report and that experience is characterized by a slew of grievances, arbitrations, litigation, high attrition rates and rock-bottom employee morale.

The problems may differ from agency to agency, but the reality is that each of these programs is terribly flawed. At FDIC for example, the pay-for-performance program was so flawed with only 12 percent of employees finding it viable, the entire program was just suspended. Yet, FDIC is one of the agencies included in the OPM report of pay-for-performance success stories.

The report also showcases the Transportation Security Administration’s dysfunctional PASS system, a pay system so flawed that uncertainty has resulted in the highest attrition rate in government. I will address the FDIC case and the failed PASS system later in this testimony.

I want to emphasize that nothing in this OPM report, or any other government study I have found, indicates that the General Schedule system should be modified along pay for performance lines. The GS system is not based on longevity but on the successful performance of employees. This is a performance-based system that works.

And for those who argue that raises are automatic within the GS system and say the only thing that counts is *being there*, I take issue. An employee’s supervisor must certify that the employee is performing the job up to standard. If not, the employee’s step increase can be withheld and disciplinary action can follow. If there’s a problem here, it’s that the supervisor is not doing his or her job. Can we expect them to do a better job with a much greater task, the kind of task that is involved in each and every one of the pay for performance systems presently in the government? It took a very long time to build a non-partisan, professional civil service that is envied around the world. There has been no evidence so far that it needs to be changed.

NTEU and Alternative Pay Systems

While NTEU stands ready to contribute to measures leading to a more effective and efficient federal government, my concern is that the Administration has moved forward on pay alternatives without first demonstrating that a problem exists. It has not brought forth the kind of comprehensive impartial data-based research explaining why it finds the GS system I described as inadequate. Nor has it required agencies to use the many authorities and flexibilities already available to them to offer alternative pay and benefits.

I would like to comment specifically about several alternative pay systems that NTEU has been involved with, including the Federal Deposit Insurance Corporation (FDIC) system, the Securities and Exchange Commission (SEC) which the subcommittee is examining, the IRS' paybanding system that currently covers only managers, the Department of Homeland Security (DHS) and the problematic Transportation Security Administration's (TSA) PASS system.

Let me point out that alternative pay and personnel systems have a very small, if not negligible, impact on recruiting, retaining and maximizing the performance of federal employees. To quote Robert Behn, author and lecturer at Harvard University's John F. Kennedy School of Government, "Systems don't improve performance; leaders do." In his book, *The Human Equation: Building Profits by Putting People First*, Jeffrey Pfeffer, of Harvard Business School says, "Although variable pay systems that attempt to differentially reward individuals are clearly currently on the increase, such systems are frequently fraught with problems. Incentives that reward groups of employees or even the entire organization...are customarily preferable." (p.203)

I believe leadership that solicits, values and acts on the ideas of frontline employees in efforts to achieve agency missions is missing in many agencies today. Providing that kind of leadership would do more to improve the quality of applicants and performance of employees than alternative personnel systems and so-called pay for performance projects as proposed by this Administration. Let me bring to the subcommittee's attention the following examples of alternative compensation systems which are all problematic.

FDIC

Last week, I announced an agreement between NTEU and the Federal Deposit Insurance Corporation (FDIC) to suspend the FDIC's pay for performance system covering employees for the 2007 performance cycle. The system had generated a great deal of resentment among FDIC employees and did little to actually motivate people or foster teamwork. Recognizing the low level of morale at this important federal financial regulatory agency, which was highlighted in an extensive survey of all FDIC employees by the respected, independent organization (the Hay Group), FDIC Chair Sheila Bair, held a series of discussions with NTEU and, to her credit, agreed to the suspension. Parties will now review options for a more transparent, credible and fair pay system going forward.

As I mentioned to the subcommittee in previous testimony, NTEU strongly believes that in the absence of a statutorily defined pay system, like the GS system, pay should be subject to collective bargaining, as it is in the private sector. NTEU's ability to bargain at FDIC had the benefit of bringing employee concerns about the flawed pay system to the forefront.

The Hay Group Report (*FDIC 2007 Employee Engagement Initiative, Dec 21, 2007*) found only 12 percent of FDIC employees said they found the pay-for-performance system to be a fair program for rewarding employees' performance and contributions. Fewer than one in three said they believed the pay-for-performance group assignments – which were key to determining pay—were an accurate reflection of performance and contribution.

This was not a surprise to NTEU. NTEU has been at odds with FDIC's system to determine performance-based pay for some time. Several years ago, the FDIC divorced its pay system from its performance management system, and established a separate set of "corporate contribution" factors to determine employee annual pay increases. Although multi-level performance scores had recently been reintroduced as a factor in pay determinations, pay increases were still based primarily on the "corporate contribution" criteria, which are highly subjective, and not grade or job-specific. Furthermore, although pay increases are purportedly based on merit, the FDIC used a forced distribution system in determining employee pay increases: employees in each organizational component needed to be "ranked," and the top level pay increases were limited to the top 25% of employees.

This system of forced rankings and pay distributions had demoralized and angered FDIC employees. Our members report that the system was divisive and discouraged teamwork. It was discouraging employees from taking risks, and sending the message that three quarters of them could never be considered to be top performers, regardless of how well they perform. The forced ranking system, under which employees from different work units with different supervisors were ranked against one another, smacks of a "star chamber" approach to pay-for-performance.

With the heavy reliance on vague and subjective "corporate contribution" factors, employees did not clearly understand what they must do to be evaluated at the highest level. And the forced ranking system prevented them from ever knowing how this might translate into a pay increase, so that the pay system does little to actually motivate performance. The system, therefore, lacked transparency and credibility, and has caused employees to question its fairness. Hundreds of individual grievances have been filed alleging unfair pay determinations, as well as mass grievances alleging discriminatory impact based on age and race.

As the Hay report points out: There is a need for a fundamental change in the FDIC culture, to support employee creativity, innovation, and the exercise of professional judgment, so the FDIC can fully utilize the talents, ideas, and expertise of its employees. I commend Chair Bair in coming to an interim agreement with NTEU on this pay fiasco and look forward to reaching more extensive solutions to employee pay systems down the road.

SEC

In my opinion, any alternative pay system must be fair, credible and transparent. And employees must know what their work expectations are, and what they need to do to improve. Unfortunately, the Security and Exchange Commission (SEC) has failed on all accounts.

Congress authorized SEC to establish a pay system outside of the General Schedule and NTEU has negotiated with the Commission over this since 2002. Its pay-for-performance system is based not on a forced ranking system like FDIC's but rather on a forced *distribution* system with merit step increases designed to fit within an identified budget which is naturally too low to accommodate serious raises. Vague, subjective and generic criteria unrelated to positions were used for determinations about raises. And at one point, SEC broke the GS- 10 step pay

scale into 31 steps with each step being worth a certain percentage of salary. As you can imagine this was all very confusing to employees.

But much more troubling is a pattern of discrimination in pay at the agency. NTEU took the agency to task and filed grievances against five pay for performance systems charging that they discriminated against groups of employees protected under federal anti-discrimination statutes. In September, 2007, we won the first important legal battle when an arbitrator ruled for the union that SEC's implementation of its 2003 pay-for-performance system was illegal. This faulty system was found to be discriminatory against African American employees above Grade 8 and employees aged 40 and older.

The arbitrator found that African-American employees above grade 8 and older employees received significantly fewer pay increases than would be expected given their representation in the pool of eligible employees. He ruled that since the SEC's subjective system for awarding pay increases was not valid or even reasonable, the pay-for-performance program violated Title VII of the Civil Rights Act as well as the Age Discrimination in Employment Act.

Among the multiple issues with the SEC system is that it used a set of vague and subjective 'agency success factors' to determine whether and how much of a merit increase an employee would receive. The generic factors were not linked to employees' job duties and applied to every position within the SEC, from administrative staff to IT staff and to attorneys, accountants and other professionals.

They were based on such amorphous criteria as whether employees "focus on achieving results while adapting to changing priorities" or "present information accurately" or "gather and evaluate information to develop effective solutions" or "collaborate with others." The subjective and arbitrary judgments managers were required to make was compounded by the lack of training and guidance the SEC provided them.

It is no surprise, therefore, that the SEC's implementation of this program was a failure. NTEU warned the SEC that employees would not know how to satisfy these vague standards, that arbitrary treatment would occur, and that grievances would undoubtedly follow. This is the first of five pending grievances NTEU had filed challenging the use of the system for each subsequent year, including the 2007 performance period. Those grievances also allege that the system violates federal law, the NTEU compensation agreement and the NTEU-SEC collective bargaining agreement.

Meanwhile, while these grievances are pending, NTEU is trying to engage SEC in efforts to make more sense out of the pay system. But the agency's efforts to date have been focused on developing the new system for its executives and managers, so little has been done thus far on developing new performance standards for bargaining unit employees, training managers on the new system, or determining the precise correlation between employee ratings and employee pay increases. For now, the SEC has continued to determine employee annual pay increase based on the flawed system currently in place.

IRS

The Internal Revenue Service (IRS) has a pay banding performance based compensation system. While bargaining unit employees represented by NTEU are not covered by this alternative system, managers participate in it. I do not want to speak for the managers but I think it is safe to say they have not embraced the system.

In their June 18, 2007, public comments on OPM's proposed regulations to revise the criteria for IRS broadbanding systems (*Federal Register April 17, 2007*) the Federal Managers Association highlighted several problems with their pay banding system. The theme that ran through their comments is the notion that under the administration's pay banding proposed regulations, pay is not necessarily dependent upon the *performance* rating. And isn't that the alleged purpose of these alternative pay systems? I'd like to quote from the managers' June 18th comments on the Administration's broadbanding proposals:

Any reform of the current system must eliminate the current service-wide performance ratings caps. For the IRS personnel system to be truly pay-for-performance, there cannot be arbitrary caps on the number of higher ratings. Managers must receive the ratings their performance dictates and they should not be harmed by a *capricious ceiling*. For any personnel system to be fair and effective, evaluative ratings and performance awards must be based on merit, not *forced quotas*." (*June 18, 2007 public comments (emphasis added)*)

The Managers' comments also spoke to how the current award pools fail to adequately reward managers for performance and for the compensation risk they believe they face.

After these comments came out, on July 3, 2007, the Treasury Inspector General for Tax Administration (TIGTA) released a report (2007-10-106) titled, "*The Internal Revenue Pay-for-Performance System May Not Support Initiatives to Recruit, Retain, and Motivate Future Leaders*." The TIGTA report found a number of serious deficiencies in the pay for performance system at the IRS. Most alarming to me, Mr. Chairman, was the sentence on page 1 of the report under "Impact on the Taxpayer" and I quote:

"In addition, the new System was not adequately communicated to the managers before it was implemented, causing opposition and decreasing morale. As a result, the IRS risks reducing its ability *to provide quality service to taxpayers* because the Internal Revenue Pay-for-Performance System potentially hinders the IRS' ability to recruit, retain, and motivate highly skilled leaders." (*Emphasis added*)

I believe we cannot ignore the bottom line mission of the agency in these pay experiments. If these alternative pay systems are jeopardizing the achievement of an agency's core mission – in this case to provide quality service to taxpayers—how can we justify more experiments with these systems that have questionable successes?

In its report, TIGTA found: 1) the system discouraged both managers and non-managers from applying for managerial positions; 2) performance based pay increases were not necessarily commensurate with a manager's performance; and 3) the Human Capital Office (HCO) did not adequately communicate with affected managers, which increased opposition and decreased

morale. I need not remind you, Mr. Chairman, that the point of this pay experiment was to attract quality talent to offset an expected dearth of government managers when nearly 90 percent of high level government managers will become eligible to retire in the near future. These dismal findings hardly confirm the predictions of success.

Finally, as I pointed out to this subcommittee last year, shortly after the TIGTA report was issued we understand the Federal Managers Association (FMA) revealed its own misgivings about the direction of the system in its newsletter to FMA members. Most revealing was its internal survey which showed that 92 percent of respondents answered “no” when asked if the current performance management system accurately identifies the truly ‘outstanding’ managers. (*FMA newsletter 2007-11, July 10, 2007*) Further, FMA agreed with TIGTA that communication with employees needs to be more “open and timely” with respect to pay before changes to pay and benefits can be made.

Now, as amazing as this sounds, we understand the IRS will be hiring a *contractor* to assess this program. I cannot imagine where the logic of this lies and I urge the subcommittee to look into hiring outside experts to assess a failing pay system.

Despite dismal results of these systems, they continue to be showcased as models for moving the whole federal government to pay-for-performance systems. There is a dearth of information to indicate that alternative pay systems have had any significant impact on recruitment, retention or performance. A GAO report on “Human Capital, Implementing Pay for Performance at Selected Personnel Demonstration Projects” from January 2004 (GAO-04-291) included virtually no evidence that the systems improved any of those measures. In fact, the Civilian Acquisition Personnel Demonstration Project, reviewed in that report, had as one of its main purposes, to “attract, motivate, and retain a high-quality acquisition workforce.” Yet, attrition rates increased across the board under the pilot.

DHS and TSA

Mr. Chairman, my July 31, 2007 testimony discusses in detail some of the pervasive problems at the Department of Homeland Security (DHS). Today I’ll not focus on department-wide issues except to point out that despite being ranked at the bottom of the Partnership for Public Service’s annual survey of “Best Government Places to Work”, DHS is insistent on moving forward with an alternative personnel and pay system. Fortunately, however, the agency has not been provided the funding to do so.

I would like to focus now on the alternative pay system for Transportation Security Officers (TSOs) at the Transportation Security Administration (TSA) called the Performance Accountability and Standards System (PASS). While this agency technically resides within DHS, its PASS system is an entirely separate pay system. And it is in disarray. Problems with PASS are so numerous, it’s hard to list them all – employees are constantly tested, but if they fail, they’re not told what they did wrong. The training is minimal. A majority of screeners don’t even really know what they have to do in order to get a pay raise. This year, the pay raises were adjusted so that more people would get some amount of a raise. Unfortunately, since

there's only so much money to go around, many of the top performers from last year find that their rating is the same, but the pay raise is smaller.

OPM hails this system as a "key element in the long-term professional development" of the screeners. Nothing could be further from the truth. Supervisors need to keep a small booklet of ratings on each employee. Some forms don't get filled out, some get lost. Retraining is difficult, because there are no materials, and no time to review the materials if there are any. It's a system easily abused. OPM can say what it will about the GS system, but that system is one where people know exactly what is expected of them and exactly what they can expect to get out of it. The uncertainty in PASS has resulted in the highest attrition rate in the government. And there is no professional development.

The TSA PASS system should be eliminated and it is critical that TSA screeners be put into the General Schedule pay system. NTEU would support legislation to require this.

Going back to my earlier comments about OPM's performance-based pay systems report, the notion that PASS was created to offer "significant compensation" to the screeners is a joke. TSOs' average pay is \$30,000. They never know if they will get a raise or not. Pay increases are sporadic and unexplained.

Mr. Chairman and Members of the subcommittee, unfortunately, I do not believe the experiments in alternative pay systems like the ones I have described can be any sort of model for positive change. It is a mystery to me where the evidence is that these systems have produced successes to justify putting them in place throughout the federal government.

OPM and Flexibilities

Mr. Chairman, the subcommittee has pointed out -- and we have all read in the media -- that a surge in federal retirements could occur in the next several years. The Council for Excellence in Government & Gallup Organization recently reported that 60 percent of the federal government's General Schedule employees and 90 percent of the Senior Executive Service will be eligible to retire in the next ten years. (*Within Reach . . . But Out of Sync: The Possibilities and Challenges of Shaping Tomorrow's Government Workforce*, "December, 5, 2006).

While no one knows for sure whether all of those eligible to retire will actually do so, I do know that the federal government had better be prepared to compete for the best and brightest of the young new workers. Just as importantly, however, it must be prepared to use its many existing authorities and flexibilities to *retain* the hundreds of thousands of talented public servants who have the knowledge and expertise to continue contributing to the federal workforce. The failure to pay competitive salaries, the constant focus on downsizing and outsourcing and the bashing of federal bureaucrats have put the federal government at a disadvantage when it comes not only to hiring the best new college graduates, but also to retaining its current employees.

Unfortunately, many federal agencies have been lax in utilizing their existing authorities and administrative personnel rules to retain the thousands of dedicated public servants who are

currently working in our federal agencies. I contend that we should not plunge forward with untested pay experiments until we require OPM and the agencies to use existing flexibilities.

During the debate over the Bush Administration's ill-conceived proposal to change the GS pay system, I pointed out that there are a host of provisions on the books that allow the federal government to reward high performers, including recruitment and retention bonuses, quality step increases and paid time off awards. These options are often not used because agencies are not given the resources to fund them, or agencies find it cumbersome to ask OPM for authorization.

But before we spend more taxpayers' money designing entirely new compensation systems, the Office of Personnel Management (OPM) must do more to make sure agencies are aware of these existing provisions and are given the necessary tools to use them to their maximum capacity.

The Office of Personnel Management (OPM) issues a manual of authorities and flexibilities that is currently available to the different federal agencies under Title V of the US Code, entitled *Human Resources Flexibilities and Authorities in the Federal Government*. It essentially contains a list of flexibilities and authorities under which federal agencies can make personnel accommodations to attract candidates to the federal government or to offer incentives for federal employees to remain in their government jobs.

The Government Accountability Office (GAO) has undertaken a number of studies focusing on the importance of designing and using human capital flexibilities. In one report (GAO-03-02), the GAO found that the flexibilities that are most effective in managing the federal workforce are those such as time off awards and flexible work schedules. In other words, flexibilities are in place for employees and agencies to agree upon set times off to better balance the demands of career and family life.

Unfortunately, OPM has not focused extensively on advertising existing authorities and flexibilities. OPM states in the Preface of its handbook, "We serve as a resource for you as you use existing HR flexibilities to strategically align human resources management systems with your mission." (*p.i*) yet, most federal agencies do not take advantage of them. Agencies can offer numerous awards as incentives to employees. These range from things like cash awards to individuals and groups; to quality step increases; to retention allowances; to foreign language awards; to travel incentives; to referral bonuses and others. Before Congress moves to pass new laws, it should require OPM to promote existing authorities, and aggressively require federal agencies to examine current avenues available to them to recruit and maintain their federal employees.

I would like to address just a couple of options the agencies now have available.

First, Telecommuting. Agencies can now offer telecommuting, also known as telework, or programs that allow employees to work at home or another approved location away from the regular office. While existing flexibilities exist on telecommuting, Congress has also acted to promote its use. In the FY 2006 State, Justice Commerce Appropriations bill, language

was included in Sec. 617 requiring each department or agency to report to Congress on telecommuting and to maintain a telework coordinator. Earlier, in 2000, Congress passed legislation requiring executive agencies to establish telecommuting policies to the extent possible. And NTEU has negotiated telework agreements with management in many federal agencies.

In surveying the thirty agencies represented by NTEU, we found mixed results in terms of management's commitment to the concept. Experience has shown that telework can bring increased productivity due to uninterrupted time for employees to plan work and carry it out. It also saves energy, reduces air quality problems and congestion on our roads while enhancing the quality of family life. We found successful programs at the IRS and the Patent and Trademark Office. NTEU has also found various forms of resistance at other agencies. The Security and Exchange Commission has model policies but there has been resistance by mid-level managers. At the Bureau of Alcohol, Tobacco and Firearms (AFT), management engaged in foot dragging for years resisting even a modest program.

There is no doubt in my mind that OPM could be playing a more prominent role in assisting agencies to move forward on their telecommuting and telework policies.

Second, Compensation and Salary. Mr. Chairman, a quick look at OPM's handbook will show the many areas in which OPM and federal agencies have the authority to offer special salary and compensation without requiring additional legislation. I have called upon the OPM Director, for example, to grant Special Salary Rates under Title V to federal workers in the New Orleans area who continue to face skyrocketing expenses like higher rents, gas, commuting costs, and insurance premiums after the devastation of the Gulf Coast Hurricanes. No legislation is needed for this. Federal agencies simply need to make their case to OPM and OPM can grant special salary relief.

Many, many other compensation flexibilities exist at federal agencies and I won't go into all of them here. But The Government Accountability Office (GAO) reported in its study of human capital flexibilities a few years ago that "monetary recruitment and retention incentives, such as recruitment bonuses and retention allowances...and incentive awards for notable job performance and contributions, such as cash and time-off awards" ranked as among the "most effective flexibilities" (GAO-03-2).

Third, Student Loan Repayments. This benefit could be critical to recruiting top notch qualified public servants. Under this existing authority, agencies may repay federally insured student loans as an incentive for attracting candidates. An agency may pay up to \$10,000 per employee in any calendar year or a total of \$60,000 per employee. I would like to see, Mr. Chairman, a report from the agencies on how many are using this excellent opportunity to recruit federal employees. Unfortunately, I suspect, not many are.

Conclusion

In summary, I will be brief: 1) There is no hard evidence that the current pay system for federal employees needs to be changed; 2) The current experiments with alternative pay systems

are failing; and, 3) The government should use the flexibilities it currently has before moving to new pay system experiments.

But most of all, a federal personnel system should recognize and reward leadership, foster opportunities for input and ensure a fair compensation system that is transparent and credible.

Mr. DAVIS OF ILLINOIS. Mr. Gage.

STATEMENT OF JOHN GAGE

Mr. GAGE. Thank you, Mr. Chairman. It's a pleasure to appear before you today.

I will focus my remarks on DOD's national security personnel system and TSA's pay system for transportation security officers. Recent press reports of the 2008 NSPS payout for employees have been highly misleading, and we urge this subcommittee to demand data from DOD to explain how the system has been applied, because what they have provided so far makes any evaluation impossible.

But what we do know is subjectivity and bias plague the entire system. NSPS is supposed to set base pay and future salary increases on individual performance, judged by a hierarchy of supervisors, but senior managers at DOD have told us that different pay pools have different rules for distribution, and that supervisors have an order to tell their subordinates only their narrative ratings, not their numeric ratings, so that the latter can be changed after the fact. Surely it violates the principle of transparency if an employee cannot even see their supervisor's rating.

Because NSPS is not supposed to exceed the cost of the GS system, it must fit performance ratings into a normal distribution or bell curve. In practice, this means that numerical ratings can be changed not because of failure of employees to reach performance objectives, but to align with preset ceilings on the number of 5, 4, 3s necessary to match preordained funding for pay pool distributions. Far too many managers have carefully rated their subordinates as objectively as possible, only to be forced by the pay pool manager to reduce their ratings in order to get to the bell curve.

But it becomes more complicated than that. Employees in the same pool who were rated 3, for example, might not get the same number of shares. Further, the money put into the shares varies enormously. In some places, a share was worth 1 percent of salary; in others, it was worth 1.5; in others, it was worth 2. In some workplaces an employee who got a 3 could get more than someone else who got a 4.

Just to make matters even more complex, pay pool managers can decide how much of a share can be put into an employee's salary increase versus cash bonus, and this is enormously important. Obviously, this can affect the employee's standard of living not only while he is still working, but profoundly into retirement.

In addition, there appears to be a bias in favor of employees who work higher up the chain of command or closer to the Pentagon. I would think Members of Congress would be particularly interested in what is so obviously an inside-the-Beltway bias.

We are also concerned about the elimination of merit promotion. Under the GS system, an employee's ability to get promoted is clear from the position description. If the job is based on the career ladder, say, and starts as a GS-5, goes to a 7 and then a 9, employees know what is expected of them, and they can look forward to those promotions if their performance so warrants.

Under NSPS, promotions are likely to be far rarer. Employees might be given additional duties by their supervisor in order to ad-

vance inside the pay band, but there will be no pathway, no clear pathway, to that advancement. Nor is there a requirement that a job at the higher level be open to competition. Bias and favoritism are inevitable.

Mr. Chairman, I have dwelled on the details of NSPS for good reason. It has been so easy for the administration to spin pay for performance as a great idea. Who can argue with rewarding excellence and punishing the lazy and incompetent? AFGE argued against the establishment of the authorities that gave DOD, DHS and TSA the ability to create new pay systems. We have testified numerous times before, and we reaffirmed today that no matter how successful people may think pay for performance is in private-sector settings, it is inappropriate for the government where merit system principles must be upheld, where teamwork is paramount, where politics always threatens to corrupt the workplace, and where profit has no place.

But the administration argued that they can be trusted to create fair systems, that best practices would be followed, and that we should just wait and see how happy and motivated everyone will be once they get rewarded for their contributions.

But the reality of pay for performance is different. In any pay system like NSPS, with this much flexibility, the results must be exposed to a great deal of sunshine. The fairness, transparency and accountability promised by NSPS can only be evaluated looking at the numbers.

We urge the committee to acquire the data listed in the appendix that we are provided and to make it public. If the system is any good, it will withstand the scrutiny. If it is not, AFGE and other unions will negotiate for its improvement.

Now, transportation security officers. Just briefly, despite the public's call for a Federalized, well-trained and well-compensated screener work force following 9/11, TSOs continue to be drastically underpaid. The average salary is \$30,000, approximately equal to that of a GS-5, while other law enforcement officers at DHS are classified at much higher grades.

TSOs are also subject to the unaccountable and highly subjective performance-based pay system known as PASS. While it is virtually impossible for us to obtain data or even basic information about how this system is supposed to work, to make matters worse, TSA continually changes the system. While understandably confused about the details, employees tell us that PASS is based on favoritism, not performance.

Last December, TSA disclosed that TSO officers—that TSO officers would receive a smaller pay raise in 2008 than in 2007, even if they receive the same performance rating as the previous year. TSA consistently ranks at the bottom of any survey of employee morale.

We all know it from the tragedy suffered on 9/11 that this work force is too important to be treated so callously. It is time to provide a rational pay system for these workers before the attrition rate climbs any higher. AFGE urges the subcommittee to end the PASS system and instead place TSOs under the pay system that it applies to other Federal workers, including their colleagues throughout the DHS.

That concludes my statement, and I will be happy to address any questions.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Gage.

[The prepared statement of Mr. Gage follows:]

**American Federation of Government Employees, AFL-CIO
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STATEMENT BY

JOHN GAGE, NATIONAL PRESIDENT

AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, AFL-CIO

BEFORE

**THE SUBCOMMITTEE ON THE FEDERAL WORKFORCE,
POSTAL SERVICE, AND THE DISTRICT OF COLUMBIA**

HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

ON

PAY FOR PERFORMANCE SYSTEMS

FEBRUARY 12, 2008

Mr. Chairman and Subcommittee Members,

My name is John Gage. I am the National President of the American Federation of Government Employees, AFL-CIO, which represents 600,000 federal workers in 65 agencies across the nation and around the world, including employees in the Department of Defense (DoD) and the Transportation Security Administration (TSA).

I appreciate the opportunity to testify today on the subject of "pay for performance." While to date only a few AFGE members participating in small demonstration projects have been taken out of the General Schedule (GS) and placed under a so-called pay for performance system, the Department of Defense has the authority to apply its National Security Personnel System (NSPS) pay program to the employees in our bargaining units, and may do so in the near future. In addition, Transportation Security Officers have never been in the General Schedule, but are covered by the agency's intentionally vague and indecipherable Performance Accountability and Standards System (PASS).

Department of Defense: National Security Personnel System

We are grateful, Mr. Chairman, for your support and assistance in the FY 2008 Defense Authorization Act deliberations, that placed some limitations on DoD's ability to impose its new system on employees. First, it is a tremendous relief to wage grade (blue collar) workers laboring long hours at military installations across our nation to support our warfighters, that they will no longer be subject to NSPS.

The second limitation that you and others succeeded in achieving provides that management bargain in good faith with unions over negotiable subjects before the new pay system is applied to GS employees currently serving in our bargaining units. Third, the new law ensures that any GS employee at DoD placed under NSPS will be guaranteed 60% of the nationwide pay adjustment, and 100% of the locality adjustment granted every year to GS workers, provided that employee is rated above "unacceptable."

The protections noted above are important, but only partial safeguards from the risks of the NSPS pay system. AFGE will vigorously negotiate collective bargaining agreements that try to ensure that before the system is applied to bargaining unit members, every effort will be made to provide the fairness, transparency, and accountability that is clearly lacking in the current NSPS system.

The press reports of the recent January 2008 "payout" for employees under NSPS have been misleading. There are many questions about the methodology used in implementation, which I will discuss later in this statement. We strongly urge the subcommittee to request data from DoD to explain how the system has

been applied, because the data that DoD has provided to date are insufficient for an effective evaluation of the system. I have attached an appendix to this statement listing the data needed to conduct such an evaluation.

The Bush Administration likes to claim, falsely, that NSPS is designed to adhere to the merit system principle of "equal pay for substantially equal work". Employees who have had the misfortune of working under "pay for performance" systems know otherwise. When surveyed, federal workers express skepticism about their chances to excel in the workforce because their opportunities and evaluations depend so much upon their supervisor's arbitrary set of expectations and preferences. Stanford University Business School Professor, Jeffrey Pfeffer, understands employee apprehension about individualized pay systems, noting that "supervisors in charge of judging employees have a natural tendency to favor people like themselves." These proclivities tend to result in adverse effects on women, minorities, and sometimes older workers, who are underrepresented in the ranks of management. Indeed, women and minorities have been most likely to report dissatisfaction with pay for performance demonstration projects, arguing that pay raise decisions reflected bias rather than objective assessments of a worker's performance.

This kind of subjectivity and bias pervades the NSPS pay system. Unlike the NSPS, the GS system and the pay adjustment process contained in the Federal Employees Pay Comparability Act (FEPCA) were established upon the pay principles of neutrality and "market sensitivity" or comparability with the private sector. Salaries are set on the basis of job responsibilities, and annual adjustments reflect both the performance and experience of the job holder, and market data from the Employment Cost Index (ECI) and locality surveys. In contrast, NSPS is supposed to set base pay and future salary increases on individual performance, judged by a hierarchy of supervisors.

AFGE strongly believes that NSPS has not followed this model. Reports from senior managers in DoD administering the NSPS pay plan for those not in bargaining units have described its implementation as even more problematic than its model. We are told that different pay pools have different rules for distribution, and that supervisors have been ordered to reveal to their subordinates only their "narrative" ratings, not their numerical ratings (the latter can be changed subsequently, and determine performance pay eligibility). As a result, the direct connection between performance and the employee's compensation is lost. Without the direct feedback, the premise of pay-for-performance is undermined. Surely it violates the principle of transparency if an employee cannot see the supervisor's rating.

Because it is DoD's intention that NSPS pay not exceed the cost of the GS system, the "pay for performance" system is required to fit performance ratings

into a normal distribution, or bell curve. In practice this means that numerical ratings can be changed not because of failure to reach performance objectives, but to align with pre-set ceilings on the number of 5's, 4's, 3's, 2's, and 1's that are necessary to assure adequate funding for pay pool distributions.

Far too many managers have told us that they had carefully rated their subordinates as objectively as possible, only to be told when they went to the pay pool meeting with other supervisors that their ratings must be lowered in order to get to the bell curve. But it gets much more complicated than that.

Employees in the same pool who were rated "3", for example, might not get the same number of shares.* That number varies on the basis of:

1. the component/activity/workplace
2. the pay band (individual workplaces gave out different numbers of shares to professionals vs. technicians vs. supervisors/managers.)
3. the location of the workplace
4. the pay pool manager's opinion of how an employee rated relative to other "3s" submitted by other supervisors
5. how crucial the employee's job is judged to be relative to the Pentagon's strategic military objectives.

Further, the money put into shares varied enormously. In some places, a share was worth 1% of salary, in others it was worth 1.5% and in others it was worth 2%. Again, these could vary among and within components and all the way down to individual workplaces and individual employees. In some workplaces, an employee who got a three could get more than someone elsewhere who got a 4. Also, as mentioned above, some pay pools made distinctions among 3s, 4s, and 5s giving individuals who got the same ratings different numbers of shares. In other words, there is no consistency whatsoever.

Just to make matters even more complex, the pay pool managers have flexibility in deciding how much of a share should be put into an employee's salary increase versus cash bonus. Obviously, the more compensation placed in bonuses as opposed to salary increases has profound implications for the employee's standard of living not only in subsequent years while he or she is still working, but also into retirement. Once he or she retires, both the defined benefit portion of the pension (based on a formula using the high-3 years of salary) as well as the agency's contribution to the Thrift Savings Plan (TSP) (based on a percentage of salary) will be reduced commensurate with reduction or stagnation of salaries.

* The little data DoD has released indicates that of the employees rated as a "3", about 30% received one share, and 70% received two shares.

The "forced distribution" model is evident in the way DoD established "performance" pay to its non-union NSPS employees in 2008. Fifty-seven percent were rated "3" or average; 36 percent got a "4" rating, and just five percent received the highest rating of "5." Two percent were rated either "1" or "2" and thus received little or no raise. And despite triumphant headlines touting "average" raises of 7.6%, the ugly fact is that not all those rated in the middle level "3" got the same percentage raise. In fact, among the 62,700 "valued" employees, DoD decided that 5,425 were of so little value that they got raises smaller than their GS counterparts, or less than 3.5%.

Senior DoD managers have also explained how the work of employees in the lower grades, which cannot be linked directly to the strategic military objectives of the Pentagon, is also systematically undervalued in the NSPS pay system. For those employees, it is not enough to perform extra work or exceed their written objectives. The accomplishments of subordinates are written into the accomplishments of their superiors, even if these higher-graded people were entirely uninvolved in the work. Sometimes lower-level employees are even assigned to write up their bosses' accomplishments, and told to describe their own work as having been done by others.

In addition, there appears to be a profound bias in favor of employees who work higher up the chain of command or closer to the Pentagon as compared to those who do not. Apparently, the assumption is that no matter how significant one's assignment might be to national security, the simple fact of working further from the Pentagon is evidence that that position is not as valuable. There may also be hierarchies of this bias; we are told that while it is best to work in the Pentagon, second best is a regional command, and yet further down the ladder are those working at military installations. (I would think Members of Congress would be particularly interested in what is so obviously an inside-the-beltway bias.)

By contrast, the General Schedule is transparent, easy for employees to understand, and easy for agencies to administer. The complexity of the NSPS can be used to hide the suppression of future wage adjustments for the rank and file. Lower pay increases and the replacement of salary increases with cash bonuses will necessarily lower the standard of living for many good performers during their work years and into retirement.

In addition to concerns about loss of salary, and corresponding reductions in pensions and thrift savings plans, AFGE is also very concerned about the elimination of merit promotion. Under the General Schedule, an employee's ability to get promoted is clear from the position description. If the job is based on a career ladder (say, it starts as a GS-5 but goes to a GS-7 then a GS-9), employees know what is expected of them and they can look forward to those

promotions (and the corresponding salary increases) throughout their careers. Under NSPS, promotions are likely to be far rarer. Employees might be given additional duties by their supervisor in order to advance inside the pay band, but there will be no clear pathway to that advancement, nor is there a requirement that a job at the higher level be open to competition. Bias and favoritism are inevitable.

Outside the context of union representation, DoD employees are reluctant to utilize the formal process set up to grieve their numerical performance rating, as it is widely viewed as career suicide to do so. The NSPS system, so far, has violated even its own alleged principles of rewarding individual performance. If it is allowed to spread, the damage to the merit system will be incalculable.

Mr. Chairman and Subcommittee Members, what AFGE has been told by senior managers at DoD is that there are many problems with the NSPS pay system and we have no reason to doubt them. They are not obligated to discuss any of these matters with us at this time. It is crucial in any evaluation of a system with this much flexibility, that the results be exposed to a great deal of sunshine. With your advocacy and the compliance of the Department, the fairness, transparency and accountability promised by NSPS can be better evaluated using the numbers. We urge the committee to acquire the data listed in the appendix annually, and to share it with the representatives of the employees in the department who may be placed under NSPS in the future. It is also important that this information be publicly available on the website. If the system is any good, it will withstand the scrutiny. If it is not, AFGE and other unions will negotiate for its improvement, and continue to advocate for legislative correction.

Transportation Security Officers

Despite the public's call for a federalized, well-trained and well-compensated screener workforce following the tragedy of 9-11, TSOs continue to be drastically underpaid for the extraordinarily difficult and important job they perform every day. By TSA's own admission, the average annual pay for TSOs is \$30,000, including the pay of TSOs who have been on the job for over six years. This pay is approximately equal to that of a GS-5 under the General Schedule.

Other law enforcement officers at the Department of Homeland Security (DHS) who perform duties similar to TSOs, such as Immigration and Customs Enforcement (ICE) Detention and Removal Officers, are classified between a GS-7 and GS-11. In addition to low base salaries that have not increased for over four years, TSOs are subject to the unaccountable and highly subjective performance-based pay system known as PASS. While it is virtually impossible for us to obtain data or even basic information about how the system is supposed to work, to make matters worse TSA continually changes the system. (As with

NSPS, AFGE urges the Congress to require the agency to provide data which would allow for an evaluation of the system.) While understandably confused about the details, employees tell us that PASS is based on favoritism, not merit. Transparency is completely lacking. Last December, TSA disclosed that TSOs would receive a smaller pay raise in 2008 than in 2007 even if they received the same performance rating as the previous year.

TSOs perform duties that OPM categorizes as Compliance Inspection and Support, and are included in a group of other occupations ranging from ICE to Bureau of Alcohol, Tobacco, Firearms, and Explosives (BATF) Investigative Assistants. However starting salaries for TSOs can range from \$10,000 - \$20,000 below BATF and ICE Investigative Assistants. In addition to inexplicably low starting salaries, the PASS system makes it unlikely that TSOs will ever achieve pay parity with other federal workers in similar job categories because of the arbitrariness of the system. For instance, although TSOs can earn up to 6% additional points on their PASS evaluation performance rating by performing "collateral" duties such as clerking, equipment maintenance and records management, assignment of those duties is discretionary to TSA management and is usually awarded to TSOs based on favoritism and denied in retaliation. TSOs cannot appeal even the most unfair evaluation under the PASS system, contrary to the basic requirements for effective pay for performance systems as set forth by the MSPB.

Employees at TSA express a strong desire to move to the General Schedule so that in return for doing their jobs, they can be assured of at least a stable standard of living. AFGE would support an employee recognition system to supplement the General Schedule, but the employees' basic compensation and standard of living should not be subject to the whims of individual managers – too many of whom are incompetent.

Mr. Chairman, TSA constantly ranks at the bottom of any survey of employee morale in the federal government. We all know it – from the tragedy suffered on 9-11 – this workforce is too important to be treated so callously. The flexibility given to TSA under the Air Transportation Security Act has been abused to the point of absurdity. It's time to provide a rational pay system for these workers before the attrition rate climbs any higher.

AFGE urges the subcommittee to end the grossly unfair and inadequate PASS system, and instead place TSOs under the market-based General Schedule that applies to other federal workers, including their colleagues throughout DHS.

That concludes my statement. I will be happy to try to address any questions.

APPENDIX

In order to evaluate the NSPS pay system in terms of whether it has adhered to its legal obligation to the merit system principles, specifically the requirement of "equal pay for substantially equal work," it is necessary to have access to data that describes the distribution of pay adjustments. Data similar to what are requested here are widely available for all other federal pay systems, including the General Schedule and the Federal Wage System. As those pay systems cover close to 1.8 million federal employees, publication of similar data sets for a pay system covering just 110,000 federal employees is a modest request.

Specifically to evaluate the January 2008 payout for NSPS, the following data are needed:

1. A list of each separate pay pool, identified by service, component, activity, and geographic location.
2. For each pay pool, the following information:
 - Number of employees to be paid from pay pool.
 - Funding of pay pool as a percentage of aggregate salaries subject to that pay pool.
 - Age distribution of employees subject to each pay pool.
 - Gender distribution of employees subject to each pay pool.
 - Race distribution of employees subject to each pay pool.
 - Salary range of employees subject to each pay pool.
 - Occupations included in each band subject to the pay pool.
 - Number of 1s, 2s, 3s, 4s, and 5s awarded in each pay pool.
 - Value of shares awarded in each pay pool.
 - Number of employees awarded a 3 who received one share, for each pay pool, by race, age, and gender.
 - Number of employees awarded a 3 who received two shares, for each pay pool, by race, age, and gender.
 - Number of employees awarded a 4 who received three shares, for each pay pool, by race, age, and gender.
 - Number of employees awarded a 4 who received four shares, for each pay pool, by race, age, and gender.
 - Number of employees awarded a 5 who received five shares, for each pay pool, by race, age, and gender.
 - Number of employees awarded a 5 who received six shares, for each pay pool, by race, age, and gender.
 - By pay pool, the percentage of money given as salary increases and the percentage given as cash bonuses.

Mr. DAVIS OF ILLINOIS. Mr. Junemann.

STATEMENT OF GREGORY JUNEMANN

Mr. JUNEMANN. Thank you, Mr. Chairman, and thank you and Congressman Sarbanes for allowing me here to testify today.

IFPTE is a labor organization representing over 80,000 highly skilled professional and technical workers in the private, Federal and public sectors throughout the United States and Canada. IFPTE represents up to 20,000 workers of the Department of Defense, civil servants and 1,800-plus analysts within the Government Accountability Office.

IFPTE also represents Federal employees at the Department of Interior, Department of Energy, NOAA, NASA, EPA, CRS, the Executive Office of Immigration Review, and the administrative law judges within the Social Security Administration.

Having said that, IFPTE has significant experience with pay for performance, particularly at DOD and GAO, where our members are either currently experiencing this firsthand or have been threatened by its implementation over the past years.

IFPTE is somewhat unique when it comes to this controversial issue. For one, in the private sector we have represented members who for years have been on a pay-for-performance system. While most of our Federal locals have clearly said no to pay for performance, some of our members do welcome the concept and believe that if properly and fairly implemented, it may be able to work. This is the case among our GAO membership.

One thing is clear, however. The proper application of pay for performance in the Federal Government has yet to be realized, and one could argue that its success is many years away, if it is possible at all.

It's been the IFPTE's experience that pay-for-performance schemes, whether they are in the short demo projects or largest agencywide efforts, such as DHS or DOD, for the most part have not worked in the Federal Government. Despite what some supporters would contend, these pay systems have provided little evidence that productivity of the workers is enhanced.

In my written testimony, I also argue that the recent report of a 7.6 percent pay increase in the first year of spiral 1 of DOD is inflated and unsubstantiated. Quite to the contrary, in fact, IFPTE has seen negative impacts on the concept of teamwork, morale, potential problems related to safety in such places as shipyards, and discrimination toward women and people of color in many instances.

One of the more troubling trends with pay for performance recently has been the misguided belief by management that it is somehow acceptable to pick and choose who receives congressionally mandated yearly pay increases intended to all Federal workers who meet satisfactory ratings. Since when was it the prerogative of management to unilaterally decide to circumvent Congress' intent on annual pay increases through pay-for-performance systems?

IFPTE believes that regardless of what pay system an employee is under, when it comes to the yearly pay increases approved by Congress for Federal employees, there should be no losers and winners.

We at IFPTE are well aware of this “race to the bottom” practice, both at GAO and at DOD through NSPS. In order to even start thinking about an effective pay-for-performance system, I think we can all agree that it would have to have a strong employee buy-in; otherwise, morale, recruitment and retention will suffer, and these are things the Federal Government can ill afford.

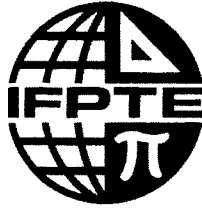
As a foundation for any pay-for-performance system, IFPTE would argue that, at the very least, pay parity among all Federal employees who have satisfactorily or meet the expectation ratings should be achieved. This can be done by mandating the annual congressionally approved pay raises guaranteed to all Federal workers, as is the intent of Congress. Given management’s prerogative to ignore Congress’ intent on the pay raise, IFPTE believes that guaranteed pay parity between agencies and various pay systems can only be achieved through legislation. Obviously, this is legislation that the union would ask your subcommittee to champion through Congress.

In my written testimony, I elaborate specifically on some of the problems within DOD and GAO relative to the pay-for-performance system, and I welcome the opportunity to discuss these with you.

Again, I thank the subcommittee for taking on this very important project and issue, and I look forward to any questions you might have.

Mr. DAVIS OF ILLINOIS. Thank you very much.

[The prepared statement of Mr. Junemann follows:]



INTERNATIONAL FEDERATION OF
PROFESSIONAL AND TECHNICAL ENGINEERS
AFL-CIO & CLC

**Statement of
Gregory J. Junemann,
President**

**International Federation of Professional &
Technical Engineers
(IFPTE), AFL-CIO**

Prepared For:

**House Subcommittees on the Federal Workforce, Postal
Service and District of Columbia**

**Hearing:
“Robbing Mary to Pay Peter and Paul: The Administration’s
Pay for Performance System.”**

**Tuesday, February 12, 2008 - 2:00 p.m.
2154 Rayburn House Office Building**

**Testimony of Gregory J. Junemann, President
International Federation of Professional and Technical Engineers, AFL-CIO, CLC**

My name is Gregory Junemann. I am president of the International Federation of Professional and Technical Engineers.

I would like to thank Subcommittee Chairman Danny Davis, Ranking Member Marchant, and all of the Members of the Subcommittee for today's invitation. I would like to also extend a personal note of appreciation to Chairman Davis and his Subcommittee staff for giving IFPTE the opportunity to testify before you today. As a union representing tens of thousands of federal workers, IFPTE commends the Chairman for his support of our nation's civil servants, who strive to meet the needs of the taxpayers everyday. The Chairman is a true champion for working men and women and IFPTE is honored to be before your Subcommittee here today.

IFPTE is labor union representing over 80,000 highly skilled professional and technical workers in the private, federal and public sectors throughout the United States and Canada. IFPTE represents upwards of 20,000 Department of Defense (DoD) Civil Servants, and 1,800 plus Analysts at the Government Accountability Office (GAO). IFPTE also represents federal employees at the Department of Interior, the Department of Energy, NOAA, EPA, CRS, the Executive Office of Immigration Review and Administrative Law Judges at the Social Security Administration. Having said that, IFPTE has significant experience with Pay-for-Performance (PFP), particularly at DoD and GAO, where our members are either experiencing this first hand, or have been threatened by its implementation for several years now.

IFPTE is somewhat unique when it comes this controversial issue. While most of our Federal Locals have clearly said 'no' to PFP, some of our members do welcome the concept and believe that if properly and fairly implemented, it may be able to work. This is the case among our GAO membership. One thing is clear however, the proper application of PFP in the federal government has yet to be realized and one could argue that its success is many years away, if it is possible at all.

It is IFPTE's experience that PFP schemes, whether they be smaller demonstration projects or larger agency wide efforts at places like DHS and DoD, for the most part, have not worked in the Federal Government. Despite what supporters would contend, these pay systems have provided little evidence that productivity of the workers is enhanced. Quite the contrary in fact. IFPTE has seen negative impacts to the concept of teamwork, morale, potential problems related to safety in such places as shipyards, and discrimination towards women and minorities in many cases.

One of the most troubling trends with PFP recently has been the misguided belief by management that it is somehow acceptable to pick and choose who receives the Congressionally mandated yearly pay raise intended for all federal workers that meet satisfactory ratings. Since when was it the prerogative of management to unilaterally decide to circumvent Congress' intent on the annual pay increase through PFP systems? IFPTE believes that regardless of what pay system you are under, when it comes to the yearly pay raise approved by Congress for federal employees, there should be no winners and losers.

We at IFPTE are well aware of this 'race to the bottom' practice, both at GAO, and at the DoD through the National Security Personnel System (NSPS). In order to even start thinking about an effective PFP system, I think we can all agree that it would have to gain employee buy-in. Otherwise morale, recruitment and retention will suffer, and these are things the Federal Government can ill-afford.

As a foundation for any pay for performance system, IFPTE would argue that at the very least, pay parity among all federal employees that have 'satisfactory', or 'meets expectations' ratings should be achieved. This can be done by mandating that the annual Congressionally approved pay raise is guaranteed to all federal workers, as is the intention of Congress. Given management's prerogative to ignore Congress' intent on the pay raise, IFPTE believes that guaranteed pay parity between agencies and various pay systems can only be achieved legislatively. Obviously this is legislation that the union would ask your Subcommittee to champion through Congress.

The following two sections will outline IFPTE's experiences with PFP at DoD and GAO to support these assertions.

Section I: DoD NSPS

DoD Pay for Performance through the National Security Personnel System (NSPS)

The DoD has already developed and implemented their own version of PFP for managers and non-bargaining unit employees. DoD, purposely, did not include the Unions in the development stages of their implementing issuances for the new pay system. Recent Congressional action restored the Unions collective bargaining rights with regard to any new PFP system. From the Unions perspective, we obviously appreciate the ability to bargain over the new pay system, however, the bargaining is starting at the end of the development of the system, versus the beginning. This puts the Unions in the position of attempting to fix a system that has already been implemented. In medical terms, instead of being allowed to prevent a disease from spreading, we are now being called upon to perform the autopsy.

Since NSPS was more an ideological experiment by the Bush Administration aimed at destroying collective bargaining, and not a personnel and pay system intended to enhance efficiency and services to the taxpayer, IFPTE and many other unions have worked together as a coalition at preventing its implementation on workers represented by a Union. However, until the recent Congressional action, our members were on deck for NSPS implementation, so we are well up to speed on its impact.

Having said that, my testimony here today is in reference to IFPTE's concerns with the current PFP system being used for managers and non-bargaining unit employees, implementing issuances that pertain to PFP, and proposed schemes to implement the new system upon GS employees. All of which were developed without Union involvement:

- **The current PFP system would harm the younger inexperienced engineers by retarding their accelerated pay growth.** Most of our engineers are hired into accelerated advancement paths. For example, an engineer with a GPA >3.0 is hired as a GS-7, assuming the engineer's performance is satisfactory, there is an accelerated advancement to the GS-9 level after 6 months, and 12 months following that increase to the GS-11. Engineers with a GPA <3.0 are hired at the GS-5 level, 6 months to the GS-7, one year to GS-9 and then 6 months to the GS-11. Some of these engineers at the Nuclear Shipyards are hired into extensive training programs, such as Shift Test Engineering or Shift Refueling Engineers, which upon completion they advance to the GS-12 level. These programs usually take two to three years to complete. The accelerated promotions are a key selling point when recruiting college graduates or these positions. There are significant bonuses associated with these training programs and maintaining the qualifications. Under the existing pay system, we can guarantee a prospective engineer that he/she will rapidly advance with satisfactory performance through the qualification process. Under the proposed pay-for-performance rules, there is no "guarantee" that with satisfactory performance they will be advanced rapidly and given the associated raises and bonuses. There is no guarantee that the money that would have paid for these accelerated promotions and bonuses will even be added to the pay raise pools for the money to be rewarded, and even if it is in the pay raise pool, the new "in-training" engineer will be competing against already qualified, experienced engineers for their share of the pay raise pool. The current system does include an Accelerated Compensation for Development Positions (ACDP) which allows for a one time subjective 20% within pay band increase and another one time subjective 20% increase when moving from band 1 to band 2. The existing GS system "guarantees" the new satisfactory engineer with up to four >23% promotions as they advance from the GS5, GS-7, GS-9, GS-11 and finally to the GS-12 pay grades, as opposed to the two subjective 20% pay raises.
- **The current PFP system would harm the mid-level engineers by retarding their natural progressive pay growth.** Upon conversion to the as proposed pay-for-performance system, our mid-level engineers, who have reached their working level (generally GS-11 or GS-12 positions) and are still progressing through the within grade step increases would be entitled to a one time pro-rated within grade step increase. If they have performed satisfactorily for 26 of the required 52 months between step increases they would receive a 50% of the step increase upon conversion. It should be noted that "buy-in" is done based on today's GS pay scale, not the pay scale with a potential Congressionally approved pay raise the following year when the actual step increase would have taken effect. Also, this is the last "step increase" that engineer will ever receive under "pay-for-performance". Junior GS-11 or GS-12 engineers can expect up to 9 step increases (depending on the initial step they were promoted into the GS-11 or GS-12 grade). Each of these step increases involves approximately a 3 to 4% raise. Each of these step increases is based upon satisfactory job performance. Under the proposed pay-for-performance system, the mid-level engineer would have to unfairly compete against a senior, experienced GS-11 or GS-12 engineer for these raises. This situation would provide quite the dilemma for management. If the pay pool raises are award based on the performance of the individuals, then statistically, the senior engineers would more

than likely out perform the mid-level engineers. The senior engineers would be rewarded with higher pay raises/bonuses than the mid-level engineers, this would have a demotivating effect on the mid-level engineer. Conversely, if management tries to compensate for the obvious inequities in the proposed pay-for-performance system, the senior more experienced engineers will be demotivated since the mid-level engineer was rewarded at a higher level for less output. The most likely outcome would be that all levels of engineers would be funneled into the "3" rating, to be rewarded equally, those denying the mid-level engineer the previous step increase raises.

- **The current PFP system would harm the senior engineers by capping their normal pay growth. This could ultimately be considered age discrimination based on the distinct group of employees that are unfairly affected.** The current proposed pay-for-performance implementing issuances require the DOD to increase the minimum pay of all pay bands, no less than the Congressionally-mandated government employee yearly raise. However, there is no mandate to increase the maximum pay of each pay band to the yearly pay raise. This allows the DOD to arbitrarily establish a pay cap on senior engineers. The DOD implementing issuances to require the engineers at the top of the pay band to be compensated, but without a corresponding pay band increase the compensation would be in the form of a bonus, rather than a pay raise. Also, current DOD implementing issuances allow the use of "internal control points" within each pay band for specific jobs/positions. The use of these internal control points is essentially an unfair pay cap on specific jobs/positions. For example, the four nuclear Shipyards put forth a proposal that the Radiological Control Technicians (RCT) with a current working level of GS-10 would have an internal control point within their pay band equivalent to the GS 10, Step 10 pay tables. Therefore, a senior RCT who had already reached the GS-10, step 10 level prior to converting to the pay-for-performance system would never be able to receive a pay raise more than the congressionally approved raises to the corresponding GS-10, step 10 pay scales. Again, any the RCTs would receive a bonus to compensate for the pay difference. (It should be noted that the corresponding regulations for management, GS/GM 13s and above, allow for up to 20% increase in the corresponding GS scale.) The new proposed pay-for-performance system would allow the DOD to "reward" senior engineers with bonuses vice the yearly pay raises. Since, all compensation through pay-for-performance is based on a percentage of one's pay, than a bonus is truly a "one-time" reward were a pay raise has a continuing "compounded-interest" effect on an employee's pay.
- **The current PFP system would continue to harm the retired engineer by reducing their TSP contributions and affecting their retirement pay.** Every little effect on an employee's base pay has multiple ramifications to the employee. Firstly, when the government converted from the Civil Service Retirement System (CSRS) to the Federal Employee's Retirement System (FERS), the Thrift Savings Program (TSP) was created to allow FERS employees to contribute to their future retirement with a percentage matching funds from the federal government based upon the amount the employee contributed to the TSP fund. These matching funds are all based upon a percentage of an employee's pay. Every reduction in an employee's pay is a corresponding reduction in matching funds from the federal government to the employee's retirement fund. Also,

since retirement pay is based upon a percentage of the employee's salary, every change to an employee's salary has an effect on the employee's potential retirement pay. As mentioned above, a bonus is merely a "one time" reward and in actuality when a bonus is given to supplement a pay raise it has a cradle-to-grave effect on the employee.

- **The current PFP system would not properly reward high performing organizations.** Another downfall of the proposed system is it only rewards high performing "individuals", there are no provisions to reward high performing organizations. The organization will only receive the amount of money for their pay pool that they would have received if still under the GS system. It is a rob Peter to pay Paul system. High performing organizations will likely have a higher number of high performing individuals, but with the same pot of money you cannot truly reward all of the high performing individuals in a high performing organization. To truly reward high performing organizations, more money would need to be added to the organizations pay pools than they would have received under the GS system. Based on the information on the NSPS website there is no compensation given to the pay pool to recognize the need for a larger pay pool for these organizations. With out a larger pool of money for pay raises, a quota system would have to be established to reward people and/or everyone would be rated at "3" and receive the basic pay raises.

Now, we have all heard and read plenty about the 2007 Pay-For-Performance Payout for the first Spiral of workers under NSPS. The DOD has released to the public that the average payout for 2007 for employees under the pay-for-performance system was a 7.6% payout. To date the DOD has not released any supporting documentation to discuss how this payout average was calculated. The following is copied directly from the DoD sponsored NSPS website:

Performance-Based Pay Increases

For 2008, payouts are effective on January 6, 2008. Employees who receive a final rating of record of 3 or higher are eligible for performance-based payouts. Pay pools are used to manage the reward process, and each is funded based on a percentage of the total base salaries of employees in the pay pool.

The pay pool fund consists of three elements:

Element 1 – *Represents base pay funds historically spent on within-grade increases, quality-step increases, and promotions between General Schedule grades that no longer exist in NSPS. Element 1 funds are typically paid out as base salary increases but may also be paid out as bonuses. For 2008 payouts, this percentage is 2.26% in the aggregate and may vary by pay pool.*

Element 2 – *Represents funds available from the GPI. Money from this source is used for base salary increases. For 2008 payouts, Element 2 is set at 1.0 percent (40% of the base salary increase of the GPI).*

Element 3 – *Represents funds historically spent on performance-based bonuses. For 2008, this amount varies by organization.*

Keep in mind, this is the very same DoD that led Congress and the public to believe that the total cost to implement NSPS on upwards of 700,000 DoD workers would only be \$158 million. That myth was later debunked by GAO, which brings me to this point: The DOD is

intentionally misleading employees by simply releasing a “number” without releasing the data that supports their number. This 7.6% payout includes the one time pro-rated within grade increase upon conversion. Also, as stated at the NSPS website, the pay pool includes the money that was historically spent on performance based bonuses. Mathematically, the DOD did not spend one additional dollar on pay raises than they would have spent without the pay-for-performance system. It should be noted that the majority of the employees in the current pay-for-performance system are managers that would have received significant Performance Appraisal Rating System-Management (PARS M) bonuses, which they would have received anyway. The non-managers are not eligible for PARS M bonuses, therefore their actual average payout would be significantly less than the managers.

Another concern about the recent PFP payouts to the managers is that the “funds historically spent on performance based bonuses” is an “organizational” pot of money. The majority of managers under pay-for-performance work in organizations that have bargaining unit employees. The money allocated for bonuses is for the entire organization, not just for managers. Therefore the money removed to “reward” these managers was from the money that should have been allocated for the entire organization, not just for managers. This means that the bargaining unit employees in these organizations will not have the same proportional money set aside for their performance based bonuses under the GS system. Again, the DOD has robbed Peter (bargaining unit employees) to pay Paul (managers). **Congress should ask the DOD to release any and all data relating to their 7.6% payout, to truly give transparency to their misguided pay system.**

Note: The following IFPTE Members contributed to Section I of this testimony: Mark Nelson (IFPTE Local 4), and Jim Winward (IFPTE Local 3)

Section II – GAO

GAO Employees Generally in Support of the Concept of Pay for Performance but Concerned About Its Implementation

Most GAO employees support the concept of a pay-for performance (PFP) system at GAO. Accordingly, the GAO union has supported a PFP component in negotiating for our 2008 pay increase. However, GAO’s employees have raised significant concerns specifically with the market-based compensation system that was implemented at GAO in 2006.

Background

GAO was among the first agencies to implement a pay for performance system in the federal sector in the late 1980s. While most employees at that time expressed concern about how this new system might affect their pay, GAO employees fared as well or better than their counterparts under the General Schedule (GS) over time and became staunch supporters of pay banding and pay for performance systems. However, the recent changes to the pay for performance system at GAO have raised significant concerns with GAO employees. Employees are concerned that the flexibilities afforded by the GAO Human Capital Reform Act legislation in 2003, have been used to employees detriment. Specifically, the

restructuring of the Band II analysts, the lowering of some pay ranges, and the implementation of a performance management system which is both confusing and inequitable, are chief among employee concerns. Despite these serious concerns and an unprecedented 2 to 1 vote by GAO Analysts to unionize under the IFPTE in September 2007, GAO analysts continue to support the concept of pay-for-performance, if and only if it does not result in lower pay for GAO employees when compared with their General Schedule counterparts. Unfortunately, this has not been the case since GAO implemented its market-based pay system in 2006.

GAO employees are generally accepting of performance-based pay systems, which have been in place at GAO since the late 1980s. When GAO first established PFP, then Comptroller General (CG) Charles Bowsher stated that the system would allow greater flexibility for staff and assured them that no one would lose purchasing power as a result of going to PFP. Further, he guaranteed that staff would not be any worse off under PFP than they would have been under the General Schedule (GS) for the executive branch. CG Bowsher continued to provide both a pay increase comparable to the executive branch cost-of-living adjustment and a merit based increase that differentiated based on employee's contribution.

GAO took steps that sustained employee acceptance of the pay for performance system. First, retention of COLAs that were the same as the executive branch resulted in general acceptance of the pay system. Additionally, GAO continued to emphasize to employees that everyone brought value to the team – it was understood throughout GAO that everyone did not have to serve in lead roles, that working as a team should be the focus, not hierarchy.

However, from the beginning of his tenure as Comptroller General, Mr. David Walker began to take steps to change the existing pay-for-performance system. When he was sworn in as CG, he stated that the organization was “out-of-shape” because some staff at the Band II level were not performing commensurate with the duties of an Analyst-in-Charge (AIC) or providing equal pay for equal work. He also asserted that ratings generally were too high. To this end, the “GAO Human Capital Reform Act of 2003” granted the Comptroller General the authority to reshape and modify GAO human capital policy, including flexibilities concerning GAO's pay system. With his new authority, the CG implemented sweeping changes to both the performance-based pay system and the performance management system that is its underpinning.

Employee Reaction to the New Performance Based Pay System

Employees are concerned about GAO's performance-based pay system (implemented in 2006 under the Act) because it offers them smaller pay increases than the prior system. GAO's original system offered full cost-of-living (COLA) adjustments to all employees who performed satisfactorily, and competitive performance-based increases to all who performed satisfactorily or better. Employees with the highest performance ratings received performance based increases that were significantly larger than those who performed

satisfactorily. In contrast, under the current performance based-pay system, employees receive sub-standard COLAs (which management refers to as across-the-board increases), and many employees who perform satisfactorily receive only small performance-based increases.

Employees concerns are not with the concept of a 'pay for performance' system, but with the specific implementation of the 'market-based' pay for performance system implemented in 2006. This resulted in the assertion that employees were paid above market wages, and a system that has since slowed-down pay increases for many GAO employees. This slow-down has impacted both the COLAs and the performance-based-pay compensation (PBC) increases that comprise pay increases.

Among employees' chief concerns are that GAO's new market-based PBC component of their annual salary adjustments is based on an inconsistent, poorly understood methodology that lacks the transparency, objectivity, and fairness that are GAO's core values. These concerns, coupled with employee dissatisfaction over GAO's reassignment of about two-thirds of its band II analysts into a lower pay band (band IIA) due to GAO's interpretation of the Human Capital Reform Act of 2003¹, were key reasons why GAO employees formed a union.

Market-Based Pay for Performance as Implemented at GAO Raises Some Controversial Issues

The lack of transparency and the complexity that characterizes GAO's PBC, have resulted in confusion and controversy over the system. To explain employee concerns about GAO's PBC, it is first necessary to explain how GAO's pay system works.

Controversial Implementation on Performance Ratings

Under the market-based PBC system, employees' raises are directly linked to their performance ratings. Performance ratings are converted to a standardized rating score (or SRS) that determines how far above or below average each employee's rating is compared to employees who are on the same team and in the same pay band. This score, effectively ranks employees with a number between -3 and +3, where -3 corresponds to the lowest rating, +3 to the highest, and 0 to the average rating. Next, GAO's management decides on the average % merit increase that employees will receive (also known as the budget factor). The performance standardized rating score is then added to the average percentage merit pay increase, and the result is the % increase that each employee will receive.

For Examples:

¹ According to the testimony by Anne Wagner, GAO's Personnel Appeals Board General Counsel, this interpretation was misinformed and the reassignment of analysts constituted illegal demotion. See Wagner, Anne *Testimony before Senate Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia and the House Subcommittee on the Federal Workforce, Postal Service, and the District of Columbia* (Washington, D.C.: May 22, 2007)

In 2008, using management's original proposed budget factor of 2.5%.

- An average employee, with a standardized rating of 0, will receive an increase equal to 2.5% of the "competitive rate," roughly the GAO-determined mid-point of that analyst's range².
- An employee in the bottom third of his or her peer group with a standardized rating of approximately -1 would receive a PBC 1% less than average, or approximately 1.5%.
- An employee in the top third of his or her peer group would receive at least 1% more than average or 3.5%³.

Controversial Implementation on Merit Pay and Bonus

Another component of the system that has been controversial is that the market-based PBC may be paid as either: (1) a merit increase – a permanent increase in basic pay, (2) a performance bonus --a one-time lump sum payment, or (3) a combination of both. This has been controversial because the actual increase to base pay is less than the published increase, which along with pay, has a negative effect on all benefits that are linked to pay. In 2005 and 2006, a portion of the PBC increase was paid as a bonus,

For Example:

In 2006, the performance bonus amount averaged about 1/2 of the total PBC. Therefore, GAO's published PBC amount for 2006 of 2.15% (see table 1 below), included a base increase of about 1.075% and a bonus equal to 1.075% of an employee's pay. As a result, base pay increased by only 1.075% merit + 2.6% across-the-board for 3.675% average total increase in base pay. This resulted in lesser pay increases over time,⁴ and lesser amounts for benefits, including pension (FERS or CSRS) and employer contributions to the pension.

Market-Based Performance Based Compensation Implementation Lacks Transparency

Yet another controversial component of the market-based PBC system is related to its lack of transparency and consistency, which has resulted in confusion among employees as to how the system works and uncertainty about how and when GAO employees receive pay adjustments. Many GAO employees have complained that they do not understand how the PBC amount is calculated, and therefore do not feel motivated by a pay-for-performance system that they do not understand. This lack of understanding is partly due to a rating score methodology that is based on standard deviations. The uncertainties in the system, such as GAO employees receiving the 2006 increase one pay period later than Executive Branch employees, and the 2007 increase three pay periods later compound the lack of transparency,

² GAO commissioned Watson Wyatt to study the market and recommend the competitive rate.

³ These numbers are for illustrative purposes only, and do not represent an actual rating score.

⁴ A CRS study commissioned by this committee illustrates the erosion of pay over time and loss of purchasing power to a GAO employee. See Copeland, Curtis "Implementation of the New Pay System at the Government Accountability Office" The Committee on Oversight and Government Reform Subcommittee on Federal Workforce, Postal Service, and the District of Columbia House of Representatives (Congressional Research Service: Washington, D.C.: March 22, 2008)

add to employees' frustration, and result in wasted time on the part of employees' in trying to understand how the system works.

Market-Based Performance Based Compensation Implementation Denies Raises to Some Employees

One final controversial component of the PBC is that pay ranges may include a "speed bump" that blocks pay increases for employees whose rating is not in the top half. Currently, the band IIB pay range has a speed bump. In 2007, 6 employees in band IIB did not receive increase to base salary⁵ due to speed bumps.⁶

Market-Based Pay for Performance Pushes GAO Employee's Pay Further behind the Rest of Federal Government

Ultimately, employees are concerned about the market-based pay for performance system because it results in lower pay and benefits for GAO employees. During the 2006-2008 period that the market-based PBC has been in place at GAO (including the recently negotiated agreement subject to ratification), GAO employees' across-the-board pay increases are 2.07% less than Executive Branch employees (see table 2 below). Further, this number does not take into account that some of the pay increase was not an actual increase because it was not added into base pay. In addition to the long-term erosion in GAO employees' pay, this also results in erosion of benefits; because these benefits are linked to pay, GAO's smaller pay increases also affect employee benefits.

Table 1: Summary of Pay Comparison between GAO and Executive Branch in the DC Area (2006-2008)

Type of Increase	2006		2007		2008	
	GAO	Executive Branch	GAO	Executive Branch	GAO ⁷	Executive Branch
Across-the-Board or COLA Percentage Pay Adjustment (Percentage)	2.60 ⁸	3.44	2.4 ⁹	2.64	3.50	4.49

⁵ Curtis Copeland's CRS study cited in the preceding footnote discussed at a great length the issue that GAO employees did not receive any salary increases.

⁶ Under the negotiated pay agreement still subject to ratification by GAO bargaining unit employees, for FY 2008, all bargaining unit employees would receive a floor guaranteed of across-the-board 4.49% salary increases.

⁷ The figure for GAO is based on GAO's management agreement with bargaining unit employees on February 8, 2008 and, as of the time of writing this testimony, is subject to ratification.

⁸ The 2006 and 2007 pay adjustments were not received for the full 26 pay periods effectively reducing the overall salary increase for that year.

Performance Based (Average Percentage)	2.15 ⁹	2.00 ⁹	2.15 ⁹	2.00 ¹⁰	2.75	2.00 ¹⁰
Total	4.75 ⁹	5.44	4.55 ⁹	4.64	6.25	6.49

Table 2: Total Across the Board 2006-2008

	10.57%
Total Across the board (GAO)	8.5%
Difference	2.07%

Table 3: Total Pay for Performance 2006-2008

	6.0%
Total performance based compensation (GAO)	7.05%

Market-Based Pay for Performance Negatively Affects Recruitment and Retention of Highly Qualified Staff

GAO's PBC system could also have negative effects on recruitment and retention of highly-qualified staff. Specifically, while Executive Branch pay ranges have been increased by the larger COLA and locality increases, GAO has linked increases in pay ranges to its across-the-board increases, which could result in GAO pay ranges not keeping up with Executive branch increases. Further, GAO's restructuring of Band II into a lower pay range (IIA) and a pay range largely based on the prior Band II range (IIB) has made it difficult to recruit staff. Prior to the restructuring, GAO's Band II spanned GS 13 and 14 pay ranges; now, GAO's Band IIA dips well into the GS 12 pay range. People from other agencies do not view a move from a GS 13 position into GAO's Band IIA as a progression in their career. For example, this becomes a problem with recruiting and retaining mathematical statisticians at GAO, a traditional federal job series. GAO typically recruits mathematical statisticians at the IIA level and has an increasingly difficult time recruiting qualified candidates. For the same reasons, it is increasingly difficult to retain qualified mathematical statisticians at GAO, as well as for other positions involving particular technical expertise.

There are also similar concerns about the retention of other analysts and specialists at GAO. As shown in the table 1 above, for the last several years GAO's across the board annual adjustments to salaries have been less than those for the executive branch. Under the PBC system, a large

⁹ According to an OPM white paper, 2.0% is historically the cost of payroll to agencies for within-grade type increases. OPM, *Alternative Personnel Systems in Practice and a Guide to the Future* (Washington, D.C.: October 2005)

portion of employee's pay increase is performance-based, and a small portion of the increase is across-the-board. Therefore, GAO employees receiving good performance ratings that are not quite good enough to be in the top half, realize that their pay will not keep up with Executive Branch counterparts, or with the high cost of living in Washington, DC. To illustrate this point, under the recently negotiated 2008 annual pay adjustment, only about 45% of GAO employees will receive pay increases that are comparable or greater than the typical Executive Branch employee in the DC area¹⁰.

Such a pay practice has impacted employees' retention at GAO. For example, some mid-career employees among others have left GAO for executive branch agencies so that they can receive more reliable annual adjustments to their pay. As a consequence, many GAO employees performing well in their jobs have received lower annual pay raises than if they were employed by an executive branch agency. Ultimately, we are concerned that this loss of GAO talent and institutional knowledge will continue if changes aren't made to GAO's compensation system, subsequently affecting the collegial team environment that GAO values and the quality of GAO products it delivers for the U.S. Congress and the American public.

Market-Based Pay for Performance and Ratings Systems Produce Unintended Consequences Related to Equity and Fairness that Can Affect Employee's Morale

In addition to the comparative disadvantage of GAO's PBC compared to the Executive Branch system, the PBC system also has significant inequities within GAO, that call into question the fairness of the system. As we discussed, the market-based PBC system is based on employee's performance ratings. As a result, numerous inequities in the rating system directly impact the fairness of the market-based PBC.

These inequities occur within teams as well as between teams, in part, a result of a ratings calculation process that is based on standardizing ratings within each team. At GAO, employee's ratings are standardized by comparing ratings to those of co-workers on the same team and in the same pay range. The intent is that standardization prevents teams from giving all of their employees a high rating, with a resulting high PBC increase. While this prevents one team from rating its employees high in comparison to other teams, it does not prevent inconsistent ratings from occurring within a team. Teams typically have several dozen staff who supervise and rate employees, with some raters who are hard, and others who may be relatively easy. The results are inequities within teams, referred to as inter-rater reliability, and discussed by Dr. Barry Seltser in May 22 testimony¹¹. Dr. Seltser cited a situation in which managers gave an employee significantly different ratings even though they were presented with the same narrative description.

¹⁰ See Appendix I, table 4

¹¹ Seltser, Barry J. "Written Statement for Congressional Testimony before The House Subcommittee on the Federal Workforce, Postal Service, and the District of Columbia, and the Senate Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia" (Washington, DC: May 22, 2007)

Another inconsistency attributed to the PBC system's use of standardized rating scores is that employees who are on stronger teams with many experienced or talented employees have a disadvantage compared to employees on weaker teams. Because the system standardizes ratings by comparing each employee to other team members in the same pay range, good performing employees who are on teams with many very strong performers receive smaller PBC increases than comparably performers who are on weaker teams.

This also results in inequities because the best performing teams are not differentiated from weaker teams. As a result, employees on a team that consistently generates more recommendations than the "average" team may receive the same standardized rating and PBC increase as employees on the "average" team.

Another inequity of the PBC system is that it is based on an appraisal system that is inherently subjective, a problem which is exacerbated by the fact that ratings are used for multiple purposes, including promotions and in reassignment to Band IIA. Because executive management has discouraged teams from giving too many high ratings, for each high rating, there are employees who receive corresponding low ratings. As a result, when managers identify a high-performing employee for promotion, in order to ensure that the employee receives very high ratings, while others must receive low ratings so that overall ratings are not inflated. Rather than rating to the standards, which is the written policy for the PBC system, the system requires managers to build the subjective judgment into the assignment of the rating scores to assure the desired outcome.

The PBC system also has a negative effect on teamwork. At GAO, employees rely on small teams of employees to conduct the audit work. Every audit consists of many hundreds of tasks, ranging from sophisticated analysis and writing to quality assurance and paperwork tasks. Successful completion of an audit requires that all team members be willing to work on any task that arises as a priority. However, the PBC system, which requires employees to compete against each other for ratings also has the effect of discouraging teamwork. Employees are less willing to perform the more routine but crucial tasks that are required to complete an audit.

GAO's Pay-for-Performance and Its Associated Ratings System Have Negative Impact on African American Employees

Disparate Treatment of African American Employees in GAO Personnel Practice

Issues with GAO PBC, its associated ratings system, and its personnel practice have crept up in many instances throughout their implementation. A case in point is African American employees who have raised concerns with GAO management about disparate treatment in job assignments, performance appraisal ratings, promotions and performance recognition and have brought discrimination suits against the agency as a result of this disparate treatment.¹²

¹² Otha J. Miller vs. Elmer B. Staats, Civil Action No. 73-996 (entered into a consent decree November 1980); Julian McKenney Fogle v. U.S. General Accounting Office, EEOC No. 091-80-X-0055, and Tyrone Delano Mason

In 2006, following the implementation of the “GAO Human Capital Reform Act of 2003”, the Employee Advisory Council (EAC) cautioned the CG about the potential adverse impact a modified PBC system would have on African American employees, particularly if the criteria used included performance ratings appraisals and job leadership experience. Despite the cautions, and longstanding disparate performance appraisal results, the CG used performance appraisals and job leadership as primary criteria to place staff in the newly created lower pay band—the band IIA.

Implementation of 2006 Modification to GAO’s PBC
Resulted In Major Adverse Impact on African American Employees

Many African American employees believe that lower ratings assigned to African American analyst staff have adversely impacted them for placement in the lower pay band. These employees believe that African Americans are disproportionately represented in the lower pay band. In addition, African American employees are concerned that lower ratings cripple their chances to compete for pay raises, promotions, and leadership roles on high profile assignments. Lower ratings also affect attrition rates whether it is keeping experienced staff on board to help provide the institutional knowledge necessary to meet agency goals or retaining newly recruited staff to meet the future demands and workload of the agency. Moreover, lower performance ratings contribute to the high attrition rate among African American male analysts especially since many leave GAO before their two year probationary period ends. While GAO is not systematically tracking retention rates, a CG Project that examined retention of GAO analysts and specialists hired during fiscal years 2002-2005, noted that, relative to band, race and year hired, differences exist in the rates of retention for certain groups of GAO employees¹³. For example, as of January 2007

- Among FY 2004 hires, retention rates were 72 percent for Whites, 48 percent for African Americans, and 91 percent for Asian Americans
- Across all four hiring years collectively (FY 2002-2005), at the Band I level, retention rates were 70 percent for Whites, 77 percent for Asian Americans, 61 percent for African Americans, and 62 percent for Hispanics.

Performance Ratings Data Confirmed Rating Disparities

After several requests from Blacks In Government, and one employee enlisting the assistance of a member of Congress to obtain performance ratings data, Mr. Walker released performance ratings statistics and acknowledged that there were disparities in performance ratings between African Americans and other group of employees but that they were not statistically significant. Yet, the CG continued to use the lower performance ratings data to

v. U. S. General Accounting Office, GAO Docket No. 02-700-82-03 (case settled October 1987 under Comptroller General Charles Bowsher).

¹³ Data taken from GAO Slide presentation given by Valerie Melvin, GAO SES Candidate, entitled CG Project: Retention of GAO Analysts and Specialists Hired During Fiscal Years 2002-2005, SES/SL Partners’ Workshop, July 23, 2007, Washington, D.C.

make critical decisions that impact work assignments and pay decisions that place African Americans at a distinct disadvantage when compared with other ethnic groups.

The CG finally acknowledged during a July 2006 "CG Chat" broadcast that performance ratings statistics for African American staff hired over the most recent 5 year period were lower than those of other groups. For example, for the 2005 Performance Appraisal Cycle, the average appraisal score for African American Band I Analysts staff with 5 years or less experience was 2.36 compared to scores of 2.69 for Asians, 2.55 for whites, and 2.468 for Hispanics. It was not until the data showed that African American staff hired under Mr. Walker's tenure was being adversely impacted by lower performance ratings that the CG proposed initiatives to address the problem. The initiatives validate the concerns of African American staff that disparities in ratings exist between African American and other groups of employee. A key component of the initiatives includes enlisting the expertise of an outside consultant to study conditions that led to the ratings disparities and provide recommendations for improvement.

Conclusion

In summary, employees are concerned about significant inequities, lack of transparency, and inconsistencies in GAO's 2006 market-based PBC system. These include

- Smaller pay increases than GAO's prior pay-for-performance system
- Smaller total pay increases than the executive branch
- System is linked to a flawed and inequitable performance rating system
- System has significant inconsistencies and flaws and is not well understood by employees
- System denies raises to adequately performing employees
- Ratings system negatively impact African American employees

GAO employees are concerned that the PBC systems is lowering morale and putting the agency at risk of losing talent in recruitment and retention, in particular among employees in hard to fill technical positions and among African Americans. While employees overall support a pay-for-performance system and the concept of merit-based pay, they are concerned that the implementation of the current systems is a step in the wrong direction. While the GAO union was not able to address these matters in its 2008 pay negotiations, it is hopeful that future discussions can result in a system that incorporates the concepts of equity and purchasing power for all, while allowing high performers to be rewarded for their particular efforts.

Appendix I: Impact of "Market-Based" Pay for Performance System on Staff

Table 4: Total Percentage Increase to Base Salaries for Bargaining Unit Employees for 2007 & 2008

Percentage Increase to Total Base Salary (Across the Board Adjustments + Performance Based Compensation)	2007 (2.4% ACB, 2.15% PBC, no floor)		2008 (3.5% ACB, 2.75% PBC, 4.49% floor)	
	% of Employees Receiving Increase	Cumulative %	% of Employees Receiving Increase	Cumulative %
0.0%	3.8	3.8	0.0	0.0
>0.0-5.0%	61.8	65.6	23.5	23.5
>5.0-5.5%	13.6	79.2	8.7	32.2
>5.5-6.5%	14.3	93.5	22.6	54.8
>6.5-7.5%	5.3	98.9	26.8	81.6
>7.5%	1.1	100.0	18.4	100.0

Based on GAO's recently negotiated agreement of 3.5%/2.75% with a floor guarantee of 4.49% for all employees, almost a third of bargaining unit staff will receive a total increase to their base salary lower than 5.5 percent. In addition, compared to the 6.49% average total adjustment for executive branch employees, **up to about 55%** of GAO bargaining unit staff will likely receive a smaller increase than our executive counterparts.

Table 5: Number of Staff Receiving Either No Increase or A Partial Increase to Base Salary in 2007 Due to Salary Caps or Speed Bumps

2007	Staff Receiving \$0 or Partial Increase to Base Salary
Band I (non-PDP)	33
Band II	--
Band IIA	50
Band IIAT*	105
Band IIB	6
Total	194

* Band IIAT staff shown are those with salaries above the IIA cap before any 2007 pay adjustments.

In 2007, 194 members of the bargaining unit received only partial or no pay adjustments (table 5).

Appendix II: Acknowledgments

The following GAO bargaining unit members provided significant contributions to this testimony: Jennie Apter, Jackie Harpp, Ron La Due Lake, Daniel Meyer, Henry Sutanto, Eddie Uyekawa, and Daniel Wexler

Mr. DAVIS OF ILLINOIS. Ms. Bonosaro.

STATEMENT OF CAROL BONOSARO

Ms. BONOSARO. The Senior Executives Association very much appreciates the opportunity to share our experiences and views related to the current SES pay-for-performance system. With the creation of the SES in 1978, its members were subject to what we thought was, indeed, a pay-for-performance system requiring performance standards, detailed appraisals, and providing performance awards when warranted.

The SES pay system was changed in 2003, and for the past three annual performance cycles, senior executives have been under a new system, the principal features of which are the absence of locality pay, absolute and unreviewable agency discretion in determining annual salary adjustments, and the availability of higher pay caps to pay higher salaries to senior executives if OPM certifies an agency's SES pay and performance management system is making meaningful distinctions based on relative performance.

Our opinions about the SES pay and performance system are formed with frequent interaction with our members and by a comprehensive survey of the SES that SEA undertook just over a year a half ago. Both the survey results and the continued feedback from our membership show that changes to the pay-for-performance system need to be made. Our goal in recommending changes to that system is to develop one which is viewed fair and reasonable by both those subjected to it and those who might aspire to the SES.

One of the more disturbing findings of SEA's survey was the opinion of 47 percent of the respondents that GS-14s and 15s are losing interest in applying to the SES. Anecdotal evidence we have continued to receive indicates that the narrowing gap between SES pay and the General Schedule, coupled with the uncertainty and inconsistency of the SES system, the loss of locality pay, increased responsibilities and fewer rights, results in a less attractive Senior Executive Service.

A significant finding of our survey, which persists to this day, is the perception that agency quotas, not actual performance levels, sometimes drive decisions about performance ratings and salary adjustments. Quotas are, of course, illegal according to the regulation, but de facto or notional quotas seem to flourish. Most agencies perceive that a key factor in receiving OPM certification is to reduce the number of outstanding ratings, so downward pressures on rating levels exist within many agencies.

The certification process itself is a problem. It's an arcane, time-consuming and cumbersome process which seems to change each year. It must also be done every 1 or 2 years, and often the decision whether to certify does not come until well into the performance cycle.

Another concern is inconsistency among agencies and sometimes from year to year within an agency on how the performance systems are implemented. This inconsistency makes it difficult to assess which agencies are doing the best job of rewarding good performance.

In the 3 years of experience under the new SES performance system, one of the most striking results is the very low salary adjustments that have occurred. In the most recent year for which data is available, 2006, those senior executives rated fully successful received an average salary increase of 2 percent, far below the increase received by the General Schedule. Higher-rated executives fared only slightly better with those whose performance exceeded the successful—fully successful level receiving a 3 percent salary adjustment, and those whose performance was outstanding receiving 3.7 percent.

For the rating cycle that just ended, we have learned of a fully successful senior executive who received an annual salary increase of \$323, less than one-third of 1 percent of the minimum SES salary. We have also learned of an outstanding senior executive who was denied any salary increase or any performance award.

Attached to my written testimony is a copy of SEA's recommendations for legislative changes to fix the SES system. Our two principal provisions are to assure a minimum annual increase for those SES'ers at the fully successful or higher level, and to include performance rewards and retention allowances in the high three retirement calculation.

We also have recommendations concerning a longer certification period, minimum funding of SES salary adjustments, a minimum increase in pay for new senior executives, rules for pay tiers which a number of agencies have developed and are developing, feedback to senior executives, and greater transparency in the administration of these systems.

It is our hope that with the adoption of SEA's recommendations, the SES pay system will be one that adequately and fairly compensates those who perform the most challenging and important jobs in the career Civil Service, and a very important one which will attract quality candidates for the future.

Thank you.

Mr. DAVIS OF ILLINOIS. Let me thank you very much.

[The prepared statement of Ms. Bonosaro follows:]



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TESTIMONY

of

CAROL A. BONOSARO

President

SENIOR EXECUTIVE ASSOCIATION

Before the

HOUSE SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE, AND THE
DISTRICT OF COLUMBIA

FEBRUARY 12, 2008

Chairman Davis and Distinguished Members of the Subcommittee:

I am Carol Bonosaro, President of the Senior Executives Association (SEA), the professional association that for the past 28 years has represented the interests of career federal executives in the Senior Executive Service (SES) and those in Senior Level (SL), Scientific and Professional (ST), and equivalent positions. SEA appreciates your invitation to testify before this subcommittee regarding our experiences with the new SES pay for performance system.

The successful mission accomplishment of the federal government depends on the expertise and skills of current and future highly qualified, experienced and able career Senior Executives. While this is true each and every day, it is especially important during a transition from one Administration to another. Therefore, fostering an SES pay and performance management system that is guided by the public interest in maintaining the best career corps possible is vital.

Unfortunately, the history of SES pay has not always advanced this public interest. For more than a decade before the new SES pay and performance management system became effective, Senior Executives in the federal government had been the great losers when it came to pay. Both the percent and actual dollar gap between the top earning potential as a Senior Executive and the top earning potential of a General Schedule employee had shrunk considerably, and 70% of all Senior Executives were capped and earning the same salary, regardless of rank.

Under the new pay system this phenomenon is only more pronounced. At this point, there appears little incentive beyond prestige and the opportunity to make a greater contribution to government for moving from a General Schedule (GS) position to one in the SES. In fact, we have even received reports of Senior Executives who have requested to return to the General Schedule because of the vagaries of the SES pay system.

The SES pay for performance system has resulted in a host of problems, ranging from lowered morale to a hastening of the retirement wave. Without a change that makes the SES system more predictable – and therefore, more attractive - there will remain a powerful disincentive for highly qualified employees to compete for SES positions. Such a situation could ultimately affect the efficiency of the federal government altogether, given the critical role Senior Executives play in program and policy implementation.

Since the new pay system has been adopted, SEA has had a clear interest in ensuring the success of this new system, with its higher pay caps even though these higher pay caps still are not available for those agencies that have not sought or obtained certification. Our efforts have been directed towards ensuring that the system would be fair and effective and seen as such by the executives subjected to it.

Nonetheless, over the past several years SEA has received complaints regarding the system's implementation. In 2006, when concerns about the new pay system

persisted, we decided to conduct a survey to obtain information from the executives themselves regarding their experiences with and views of the new system.

Our survey showed that while over 96 percent of respondents believed they should be held accountable for performance, 86 percent said the new system had no effect on performance, and 56 percent said it had no effect on their motivation. Meanwhile, 40 percent saw the system as having a negative effect on morale. The results of the survey clearly identified three major issues that must be addressed: (1) Many Senior Executives believed that performance ratings were being affected by the existence of de facto quotas; (2) Senior Executives saw no clear, consistent correlation between ratings and pay adjustments or how bonuses were distributed; and (3) Senior Executives receiving a fully successful or higher level rating often received no salary adjustment.

One of the most important set of findings affecting the impact of the SES pay system on the future were: (1) with 31 percent of SES then eligible for retirement, and 90 percent projected to be eligible over the next ten years, 16 percent of respondents indicated that they were accelerating their plans to separate from the government due to the pay system; and (2) 47 percent indicated the new system had had a negative effect on interest in the SES by GS-14s and GS-15s.

More recently we have heard of a Senior Executive with a fully successful rating who received a salary adjustment of only \$323. Such a number amounts to about \$12 a pay period. Even worse is the example of a Senior Executive with an outstanding rating this past year who received no salary adjustment or performance award.

A new concern that has recently surfaced is the creation of pay tiers to distinguish among Senior Executives. The SES at DoD will be on these tiers. Our concern is to make sure that those in the SES understand what needs to be done to attain the next higher tier and that the tiers not be used as a basis for holding down SES pay levels.

In the three years of experience under the current pay for performance system, OPM has made some improvements to the SES pay system such as its requirements to agencies to share information about pay adjustments, performance awards and compensation policies with their Senior Executives. Despite these improvements, many of the problems reported in our 2006 survey remain.

It is imperative for Congress to take a hard look at the risk, pay and incentives in the current SES pay for performance system. This system is not attractive and will continue to dissuade many of the best employees from aspiring to the highest ranks of the career civil service.

One area that should be examined is the certification process conducted by OPM. One byproduct of this process is enormous cost related to the preparation of reports for OPM and the extra staff, training and money spent on consultants just to prepare for OPM's certification review. Some smaller agencies have not even applied for certification, and thus cannot pay higher salaries, because the process is so onerous.

Many other pay systems rival the SES corps for pay and provide greater benefits without the inherent risk of being in the SES. When addressing groups of Senior Executives and candidates for the SES, I regularly hear reports of talented, experienced GS-15's who have no interest in competing for promotion to the Senior Executive Service, to earn salaries of as little as \$120,000 a year in high-cost areas, work long hours, receive no locality pay or yearly automatic cost-of-living pay adjustments, earn no compensatory time, and have no assurance that they will not be moved to a new geographical area at the discretion of their agencies. Further, there is no uniform requirement for a specific pay increase upon entry to the SES. I have received these reports, as well, from staff of the Federal Executive Institute, with regard to the GS-14's and 15's who attend courses there. With 90% of the SES eligible for retirement over the next 9 years, Congress must immediately address the risk-reward ratio in the SES corps.

Critics point to the respectable salary cap of \$172,200 for Senior Executives in agencies with certified performance management systems and say this should suffice. Although most executives would earn much more in the private sector, they have been willing to accept pay that was not comparable because of their desire to do the most important work in the nation. The fact is, however, that most Senior Executives do not earn the maximum available pay. Further, the current pay for performance system is structured in such a way that many of those who work at levels below the Senior Executive Service are reaching well into the SES pay band.

Under its partially implemented National Security Personnel System (NSPS), the Department of Defense has increased the ceiling for prior GS-15 step 10 managers by 5 percent. When combined with locality pay, the top GS pay overlaps SES pay. Also under NSPS, GS employees can now receive substantial bonuses, formerly a unique feature of the SES. In response to the GS-15 pay cap, other departments and agencies have also taken steps to increase GS-15 managers' pay even though these managers have fewer responsibilities and more rights than members of the Senior Executive Service. According to the February 4, 2008 edition of the Federal Times, the average raise for NSPS-covered employees was 7.6 percent, more than twice the 3.5 percent average raise that most other federal employees received, and more than three times the 2.5 percent allowable increase in rate range afforded to the Senior Executive Service in 2008.

Other major observations about the SES pay system is the increased potential for politicization that results from a pay system where so much unreviewable discretion is given to those who make salary decisions and the tremendous inconsistency among federal agencies on how the SES pay system is implemented. These concerns also make Congressional oversight of the SES and the SES pay system more difficult.

Before addressing several recommendations, it is worth noting the degree to which the pay for the Executive Schedule (which sets the caps for SES pay) has fallen behind in comparison to the General Schedule. The SES pay ceiling has not kept pace with General Schedule pay adjustments, that is, adjustments for the pay of employees that these executives supervise. If the Executive Schedule had kept pace with the national

comparability increases provided by the General Schedule since 1994, EL II (the 2008 cap for SES pay in certified agencies) would be \$ 226,859, not \$ 172,200.

These are the caps. The actual salary adjustments received are far below the increase for the general schedule for those Senior Executives at the fully successful level. In 2006, the latest year with data released by OPM, Senior Executives at the fully successful level received an average salary increase of only 2%. Those at the "exceeds expectations" level were awarded a 3% increase, while the best performers, those at the outstanding level, came away with 3.7%. These results are disappointing and are certainly less than the levels that should be seen in a pay for performance system that is fair and that is expected to appropriately reward those who are covered by it.

Our final concern about the SES pay system seems more applicable to smaller agencies, but could apply to larger agencies as well. SES salary increases are not required to be made. Agencies could make salary adjustment decisions for its Senior Executives based on budget considerations. General schedule salary increases must be paid by law. We believe some similar requirement should apply to the SES.

The legislative remedies we propose are common sense solutions. For example, a Senior Executive who receives a rating of fully successful or higher should receive a salary increase sufficient to keep pace with the rest of the civil service.

We also believe that the SES pay system should be reformed to recognize the reality that performance awards are part of SES pay. These awards should count toward retirement, and our legislative proposal suggests a way to do this. Another remedy we propose would require that an agency inform an executive of his or her final rating and the reasons for it within a reasonable period of time, namely, 60 days. Our 2006 survey reported that seventeen percent of respondents reported not having their rating discussed with them at all the prior year, while 37 percent received only a minimal discussion. Others reported that their ratings had been changed by higher level supervisor without explanation.

Attached to this testimony is a draft bill and narrative explanation that includes the above points and other recommendations that we think would greatly improve the SES pay system and increasing its acceptance by Senior Executives as a fair and viable system. We also believe that these suggested reforms will make the SES more attractive to quality GS-14's and 15's.

A full examination of the SES pay system is necessary to attract and retain the finest candidates for executive positions necessary for the day to day operation of our government, namely, those who provide continuity and institutional memory and are especially critical during the transition from one administration to another. Compensation should be reformed to attract, retain and appropriately award the best leaders who take on this task.

Members of the Subcommittee, I thank you for your time and look forward to working with you on the solutions necessary to ensure the Senior Executive pay and performance management system operates fairly and effectively.



the voice of career federal executives since 1980

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Updated: February 7, 2008

Legislative Narrative

The Senior Executive Service Pay and Performance Management Improvement Act

The following is an explanation of the SEA's legislative proposal, the Senior Executive Service Pay and Performance Management Improvement Act.

Section 1, Findings & Table of Contents – This section provides the congressional findings on which the legislation is based and the table of contents for the legislation.

Section 2, Mandatory Minimum Market Adjustment for Senior Executives Rated at the Fully Successful or Higher Level – This section provides that all Senior Executives who receive a rating of 'fully successful' or higher are to receive a mandatory market-based adjustment to their salary. This adjustment will be a formula-based percentage of their salary equal to the increase in the Executive Schedule plus any increase in locality pay in the region the Senior Executive is stationed. It will also ensure that this adjustment is applied when providing lump-sum payment for accumulated and accrued leave on separation.

Section 3, Inclusion of Executive Performance Awards in High-3 Average Salary Calculations This section requires that performance awards and retention allowances given to career Senior Executives be included in High-3 average salary calculations for retirement. Performance awards and retention allowances have been shown to be provided to high performers consistently, accounting for a significant amount of the high-performing Senior Executive's salary over the course of his or her career. By excluding these awards and allowances from credit for retirement annuities, we deprive good Senior Executives of a retirement package that reflects their true earned compensation salaries.

Section 4, Calendar Year Amendment and Certification Extension – This section would change the way agencies' performance systems for Senior Executives are now certified by OPM. Agency certification currently lasts one or two calendar years in duration and can be rescinded at any time. Agencies find this process of continuous re-applying wasteful and time consuming. It is also inelegant as the calendar year aspect generally lends itself to a gap between acceptance and implementation of certification. This section would make all certifications last for 60 months (5 years) from the date of approval,

while maintaining the ability for OPM to rescind certification. This section also requires OPM to provide the agency “clear and consistent advice” on how to comply with requirements of certification for six months before recertification or decertifying an agency.

Section 5, Transparency of Ratings for SES Officials – This section ensures that SES receive notification and feedback regarding their individual rating level and specific reasons for the rating level in a reasonable period of time (within 90 days). It also ensures that overall data is supplied on how an agency’s SES are rated, and the range of salary adjustments they receive for each rating level and the amount and percentages of performance awards. Finally, this section requires that all documents related to the SES pay and performance rating system and compensation determination be made public via agency websites.

Section 6, Transparency of SES Rankings and Pay – This section provides for a biennial survey administered by the Merit Systems Protection Board, with consultation from the organization representing the largest number of Senior Executives. The survey should track the experience and views of career Senior Executives on the Senior Executive pay and performance system. The survey must ask opinions regarding performance awards transparency, perceived use of quotas or forced distribution and other irregularities, as well as other questions perceived as necessary by the Merit Systems Protection Board.

Section 7, Assured Increase for New Senior Executives – This section assures a minimum salary increase over his or her current General Schedule salary of at least 5 percent for any person who joins the career SES.

Section 8, Prohibiting Quotas and Forced Distribution – This section explicitly writes in statute the illegality of utilizing quotas or forced distribution in rating Senior Executives.

Section 9, Assured Funding of SES Pay – This ensures that Senior Executives’ pay is funded in such a manner to ensure reasonable salary adjustments occurs.

Section 10, Reasons for rating reductions - This section requires agencies to provide a Senior Executive with reason why a rating is lowered from the rating originally recommended by a higher level supervisor. Thus, the Senior Executive will have the opportunity to understand his or her rating and in turn, gain new insight and clarity into his or her job functions and responsibilities as well as the supervisor's expectations. This encourages increased professional self-understanding within the senior executive as well as providing insight into the kind of development activities that are of value by clarifying organizational goals so they can be more readily accepted and executed. This also serves as a check against lowering ratings simply to force a defacto quota.

Section 11, Requirements related to Pay Tiers of Senior Executives - . This section is only applicable if an agency decides to implement a tier or rank system for Senior

Executive positions. It provides a justification and an explanation of the boundaries of each tier. Consequently, this section makes certain that Senior Executives understand the criteria used to place SES positions in tiers, what their respective agencies mandate for upward mobility and clearly delineates the path which a senior executive needs to follow in order to advance in the defined tiers.

A proposal of the Senior Executives Association

Updated: February 7, 2008

A BILL

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. TITLE; TABLE OF CONTENTS AND FINDINGS

- (a) TITLE – This Act shall be known as the "Senior Executive Service Pay and Performance Management Improvement Act."
- (b) HAVING FOUND-
 - (1) That 90 percent of career SES are eligible for retirement in the next decade, leading to the threat of a leadership vacuum at the top of the civil service if steps are not taken to reform the current SES system, make it more appealing to highly successful General Schedule employees and applicants from outside the Federal Service.
 - (2) The Senior Executive Service performance management and pay system has been applied inconsistently and without full adherence to rules concerning quotas, transparency and performance feedback.
 - (3) That the lack of assured pay adjustments including increases related to differences in local job markets, and the prevailing practice of consistently awarding annual salary increases to many members of the career SES that are lower than increases received by other federal employees, demoralize the current ranks and deter capable General Schedule employees from seeking to join the Senior Executive Service.
 - (4) That performance awards and retention allowances provided to the SES constitute a significant portion of their compensation and should be included in retirement calculations.
 - (5) That members of the public, Executive Branch officials and Congress have insufficient information on certification standards and methodology surrounding the SES pay for performance system.

(c) TABLE OF CONTENTS. – The table of contents for this Act is as follows:

- Sec. 1. Title; Findings; Table of Contents.
- Sec. 2. Mandatory Market Adjustment for career SES rated Fully Successful or Higher.
- Sec. 3. Inclusion of Executive Performance Awards and Retention Allowances in High-3 Average Salary Calculations.
- Sec. 4. SES Calendar Year Amendment and Certification Extension.
- Sec. 5. Transparency of Ratings and Methodology for the SES System.
- Sec. 6. Transparency of SES Rankings and Pay.
- Sec. 7. Assured Increase for New Senior Executives.
- Sec. 8. Prohibiting Quotas and Forced Distribution.
- Sec. 9. Assured Funding of SES Pay.
- Sec. 10. Reasons for Rating Reductions.
- Sec. 11. Requirements related to Pay Tiers of Senior Executives.
- Sec. 12. Effective Dates.

SECTION 2. MANDATORY MARKET ADJUSTMENT FOR SENIOR EXECUTIVES AND OTHER SENIOR EMPLOYEES AT THE FULLY SUCCESSFUL LEVEL OR HIGHER.

(a) In Chapter 53 of Title 5

(1) With consideration of amendments made by section 12 of this Act, amend section 5376 by adding after subsection (b),

"(c) Every employee in a position whose last performance appraisal rating is the equivalent of 'fully successful' or higher will receive an annual increase in base pay that is no less than the rate of increase, if any, for the Executive Schedule and the increase in the locality-based comparability payments for the area in which the employee's official duty station is located, if any, as authorized by the President under section 5304 of this title. This increase will be awarded the first pay period of January each year and is in addition to any increase awarded under subsection (b) of this section. This subsection will conform to salary requirements established under section 5376(b) (1) of this title."

(2) adding after Section 5383(d),

"(e) Notwithstanding the requirements of subsection (c) of this section, every career appointee whose last performance appraisal rating is the equivalent of 'fully successful' or higher will receive an annual increase in base pay that is no less than the rate of increase, if any, for the Executive Schedule and the increase in the locality-based comparability payments for the area in which the employee's official duty station is located, if any, as authorized by the President under section 5304 of this title. This increase will be awarded the first pay period of

January each year and is in addition to any increase awarded under subsection (a) of this section. This subsection will conform to all salary requirements established under section 5382 of this title."

and redesignate subsection (e) and as (f).

(b) In Chapter 55 of Title 5, amend Section 5551 by adding,

"(d) Any lump-sum payment made under this section must take into account any pay adjustment under to section 5376 or 5383 of this title."

SECTION 3. INCLUSION OF EXECUTIVE PERFORMANCE AWARDS IN HIGH-3 AVERAGE SALARY

(a) Amend Title V, Section 8331 by inserting after Sec. 8331(3) (H) the following:

(I) with respect to a member of the Senior Executive Service, performance awards under section 5384 of this title;

(J) with respect to a senior career employee (classified above GS-15 pursuant to section 5108 of this title), agency awards under section 4503, and performance-based cashed awards under section 4505a;

(K) with respect to a career appointee as defined in section 3132 (a) of this title and a senior career employee (classified above GS-15 pursuant to section 5108 of this title) agency allowances under section 5754 of this title.

SECTION 4. CALENDAR YEAR AMENDMENT AND CERTIFICATION EXTENTION

(a) In Title 5, section 5307, subsection (d) (3) (B), strike all through "either or both of," and insert:

"An agency's certification under this subsection shall be for a period of 60 months beginning on the date of certification, unless extended by the Office of Personnel Management for up to 6 additional months, except that such certification may be terminated at any time;"

(b) In Title 5, section 5307; amend subsection (d) (3) by adding,

"(D) The termination of certification or the failure to recertify an agency shall be preceded by,

(i) clear and consistent advice from the Office of Personnel Management to an agency about what the agency must do to continue its certification or to renew existing certification; and,

(ii) a period of at least six months following the clear and consistent advice referred to in paragraph (i) from the Office of Personnel Management."

SECTION 5. TRANSPARENCY OF RATINGS FOR SES OFFICIALS

"(a) Add after Title 5, Section 4314(c) (3),

(4) Each agency shall provide members of the Senior Executive Service with notification of their individual rating level and comments of record supporting the rating level determination within 60 days of the final determination of the rating."

and redesignating subsections (4) and (5) as (5) and (6), respectively; and

(b) amend 4314(c), as redesignated, by adding,

"(7) Each agency shall annually publish the overall number of ratings awarded to members of the Senior Executive Service at each performance rating level, and shall include the average overall salary adjustment at each level, the minimum and maximum adjustment at each level, the percentage of senior executives at each rating level who received the minimum and maximum salary adjustment and the number of senior executives who received performance awards under § 5384, as well as the average amount of those awards. Rating levels and salary adjustment information shall be provided separately for career and non-career Senior Executives. The agency shall also publish its Senior Executive Service Performance Management Plan and any other internal plan which describes a system for determining Senior Executive Service salary and bonus amounts. The information required by this subsection shall be published on an agency's internet website within 90 days of the final decision by the head of the agency concerning SES rating levels and pay adjustments for an annual rating cycle, except that the performance management and other internal plans shall be published as soon as those plans are effective."

SECTION 6. TRANSPARENCY OF SES RANKINGS AND PAY

In Title 5, Chapter 43, Subchapter II, insert after section 4314, § 4315. Transparency of Senior Executive Service Rankings and Pay.

"In consultation with the organization representing the largest number of senior executives (as defined by section 3132 of this title), the Merit Systems Protection Board shall biennially conduct and publish the results of a survey of career senior executives regarding

- (a) the level of transparency and availability of agency performance management plans and compensation policies to career SES;
- (b) the use or perceived use of quotas or forced distribution in the application of the agency's performance appraisal system;
- (c) any actual or perceived irregularities with the administration of the SES performance management system; and,
- (d) such other factors as the Merit Systems Protection Board shall determine are necessary and appropriate."

and redesignate section 4315 as section 4316.

SECTION 7. ASSURED INCREASE FOR NEW SENIOR EXECUTIVES

In Title 5, Chapter 53, Subchapter VIII, amend 5383 subpart (e) (2) (A), by striking after "may not be less than," and inserting

"five percent greater than the combined rate of basic pay and other payment provided to that individual under section 5304 last payable to that individual immediately before being so appointed."

SECTION 8. PROHIBITING QUOTAS AND FORCED DISTRIBUTION

In Title 5, Chapter 53, Subchapter VIII, amend 5383 subpart (a), by adding

"Any such determination will be made without the use of quotas or forced distribution of ratings."

SECTION 9. ASSURED FUNDING OF SENIOR EXECUTIVE SERVICE PAY

In Title 5, Chapter 53, Subchapter VIII, amend 5383 subpart (c), by adding

"In making such adjustments, the average percentage adjustment received by members of the Senior Executive Service may not be less than the average salary adjustment in the General Schedule under section 5303."

SECTION 10. REASONS FOR RATING REDUCTIONS

In Title 5, Chapter 43, Subchapter II, amend section 4313 (c), by adding (4) –

In the event that the initial rating by HR supervisory official of a senior executive is lowered, the senior executive shall be provided with a written explanation of why the rating was lowered.

SECTION 11. REQUIREMENTS RELATED TO PAY TIERS OF SENIOR EXECUTIVES

In Title 5, Chapter 53, Subchapter VIII amend section 5382 by adding –

(d) An Agency has the discretion to place its senior executive in different tiers or levels based upon level of responsibility and such other factors as the Agency deems appropriate. If an agency adopts a tier or level classification for its senior executives, it must also provide information explaining why a position is in a specified tier or level and what an executive must do to attain a higher tier or level. No Senior Executive Service tier or level may have a pay ceiling of less than Level III of the Executive Schedule. Notwithstanding the foregoing, no senior executive may be denied the increase required by subsection (e) of section 5383 of this section, merely because of that senior executive's placement in a designated tier or level.

SECTION 12. EFFECTIVE DATES

(a) Sections 4 shall take effect on the date of enactment of this Act.

(b) Sections 2 and 3 and 5 through 11, shall take effect 180 days or the following pay period after the date of enactment of this Act, whichever is greater.

Mr. DAVIS OF ILLINOIS. Let me thank all of you for your testimony.

Let me ask one boilerplate kind of question, and perhaps I will begin with you, Ms. Kelley. What do you think is driving the movement toward pay for performance in the public sector?

Ms. KELLEY. I think that agencies are looking for ways to be able to hand managers the unilateral authority to determine pay raises without having a lot of accountability required or attached to that.

You know, the complaints that we hear about the GS system really are not based on fact at all. If a—you know, I hear things from agencies such as pay raises are automatic, and they reward longevity, and that is not how the GS system is built. If that is how managers are implementing it, the problem is with the implementation by the managers, the problem is not with the system. So rather than dealing with training managers and holding them accountable for giving appropriate ratings within the GS system, they try to find fault with the system.

And also, we are looking for ways, I believe, to move the limited funds—because agencies have been faced with, in many cases, flat-line budgets—and they are looking for ways to take the money from the front-line employees and use it to recognize or reward the few that they see fit, or to use it with other things within the agency.

I just think they are not using the GS system appropriately, and I think that they are really not interested in recognizing and rewarding the front-line Federal employees. Every Federal employee I talk to, they tell me they would like to know what it is they need to do not just to succeed, but to excel at what they do. They want to be told what that is so that they can strive to achieve it. At the end of that, when they do succeed, they want the appropriate recommendation and reward attached to it, and the interested agencies are not willing to do that.

Mr. DAVIS OF ILLINOIS. Mr. Gage.

Mr. GAGE. I am probably of—well, to state it frankly, I think we just have to look at where this stuff came from. It came from people who have almost a hatred for government service, who want to shrink government service; in fact, who want to drown it in a bathtub, as one said.

I think, very clearly, that this whole pay for performance is designed for one reason, and that is to lower overall Federal pay. I think, too, that when you see some of the schemes, if we could just get the numbers on what DOD or any of these agencies are doing, I think it will really show exactly what this is all about.

But the one thing I would like to bring up to you, Mr. Chairman, about it, it's—it's so wrong where you give people a bonus that would probably have added up to the pay raise they got under the GS, but that money does not count for their pensions. That's really disingenuous, and I think that's—that in itself, these agencies these agencies won't be able to stop themselves from saving money by not being able to put it into the Federal pension system.

Mr. DAVIS OF ILLINOIS. All right. Mr. Junemann.

Mr. JUNEMANN. Yes, I guess I could certainly echo what's been said here by my two colleagues on this. When I look at what happened with the NSPS, really shortly after the Bush administration

came on, some people came over from Heritage Foundation and brought this idea of scuttling the GS system. And I had no idea it was since 1949 until I started reading these papers from the Heritage Foundation that said, OK, now, it's old, it's Truman-era legislation, and now it has to be replaced.

A lot of what President Kelley talked about was really true; that it is—in essence, there is the ability to measure and to rate employees within the GS system.

When we were in what we used to call “no-gotiations” when we were developing the NSPS meet-and-confer process, that was told to us: Well, it's an automatic increase. Well, it's really not, and if it's implemented that way because the supervisors weren't doing it properly or improperly trained, then that's what should have been fixed.

But I think it was really—it was sort of an idea that people had been sitting on for years and years, and then they finally saw they had the power to implement it, and they did. I think it was nothing more than wanting to, you know, lower the pay of Federal workers by people who have some sort of animus against Federal workers, and then they put it in NSPS, they wrapped it into that, and then said, in addition to that, let's put national security on the table with it and see if we can get rid of collective bargaining at the same time.

So I don't think there was a heck of a lot good about this. Nobody can tell me that everybody is a winner on these systems, because that's not what we have seen. There's been just thousands and thousands of losers. That has been our experience.

Mr. DAVIS OF ILLINOIS. Ms. Bonosaro.

Ms. BONOSARO. Well, I am going to speak from my parochial perspective of how this came to be in the Senior Executive Service. I think, initially, I thought this is the management theory du jour. We like to look at what the private sector is doing, say to them, this would be a good idea.

Actually, I think virtually every administration comes in and very often looks for a way to manage the Senior Executive Service, because people who come in from the outside are used to, perhaps, very often having the ability to pick their own team, and they find a lot of career executives in place that are pretty much going to be there, at least during their, “get-acquainted period.”

So we went through something called recertification a number of years ago that was proposed in the first Bush administration. It has since been thrown overboard. But that was looked at a way—it was looked at a way to get a handle on the Senior Executive Service.

I think to some degree this system is looked at that way, that you can—yes, you are assessing performance, but you are going to be able to send some messages. And with pay adjustment decisions, it is a system which can be manipulated. But I look back, too, to initially the reason that this system was able to get put in place. We had 70 percent of all senior executives capped and earning exactly the same salary.

The day that I met with then-OMB Director Mitch Daniels and OPM Director Kay Coles James, and they said, we are going to solve this problem of the pay compression, but not everyone who

is capped is going to get a pay raise. And I walked out scratching my head for a few days, because I couldn't think out of the box.

And, obviously, what they had come up with was a way to eliminate the S ranks and come up with a pay-for-performance system, because there was also a sense that a lot of these executives somehow or other were vastly overrated. There could not possibly be this many people who were performing that well. I think that was a very unfortunate premise, by the way, and a wrong one.

Mr. DAVIS OF ILLINOIS. Thank you very much.

I see that we've been joined by Mr. Sarbanes. Is the election over? I thought there was—well, some people don't have to worry.

Mr. SARBANES. We don't take anything for granted, but I voted this morning. I did vote for myself. So hopefully that—thank you, Mr. Chairman. And thank you to the panel.

Just a couple of comments, and then one or two questions. Listening to the testimony today, I was able to hear some of it on the radio as well before I got here. You would imagine that to put a system like pay for performance into place, you would need to do it under the best of circumstances to make it work, and it seems that this has been done really under the worst of circumstances. I'll leave aside for a moment whether I think it can work anyhow. But everyone—if you assumed under the best of circumstances you could implement it, you had the worst circumstances here. You had inadequate funding, so you get the result that Mr. Gage referred to where you have certain limited amount of resources for each performance pool, and then you get into this sort of allocation system which ends up resulting in very arbitrary systems, highly subjective decisions that are designed to just meet an overall agenda that is in place.

You have the fact that this is being done at a time when we're still far away from comparability between what Federal employees are making and what their counterparts are making in the private sector, and obviously that is something you need to move to, it seems to me, first before you start tinkering around with these other things.

And then you have the other fact that those implementing the system betrayed at every turn a fundamental lack of respect, and a number of you have alluded to it, for the Federal worker. And what they're trying to do—and the fact that they're—they're not just bureaucrats as they'd have you believe, they are people that are really committed to what they're doing. They have a sense of mission, and they want to perform well. They want to perform well. If you give them the tools and the resources and the support that they deserve and the leadership that they deserve.

And so this effort has been undertaken with a sort of thinly disguised agenda, it seems to me, to attack the integrity and the function of the Federal worker, and that is, I think, why there is so much resentment to it. It also comes at a time sadly when we're trying to recruit into the ranks of our agencies and the Federal Government the best and the brightest to serve there and to address some of the attrition that has occurred, some just because of the passage of time, but some as a result of this conduct on the part of the administration which has undermined morale.

There is hundreds of thousands of jobs that need to be filled in the coming years, and we need to make sure that the Federal agencies are modeling absolutely the best behavior and the best kind of leadership when it comes to rewarding people for what they do and showing them basic respect.

The chairman did ask a question that I was going to ask, which was sort of to describe your views of what—what the agenda was here. I think that the administration—well, let me ask you this: Do you think, for example, with respect to collective bargaining rights, that the NSPS was launched and pursued with the purpose of attacking collective bargaining rights, among other goals that it had, or was it launched with maybe more responsible objectives and then got hijacked by a very strong ideology within this administration along the way? I mean, I would be interested in your comments on that.

Mr. GAGE. That is interesting.

By the way, I voted not far from where your brother lives up in Baltimore today, too.

But I think that—you know, I almost don't want to look back over the last 4 years, the fight we had about our collective bargaining rights which we saw were—it was just so wrong to take away our rights that used any type of a national security reason for it, and—but I always thought the pay for performance was really what they wanted. And to put in pay for performance, at least the pay for performance that I think they really want, it would be a lot easier to do without a union there and without any voice of employees to be able to bargain any fairness or transparency into this system. So maybe that is just a conspiracy part of me, but through this whole exercise, I always felt that the pay for performance was what they really wanted, and to get rid of the unions was a step there.

Mr. SARBANES. Yeah. Let me—can I just ask a quick question, Mr. Chairman? I know my time has run out. But to look positively toward the future in terms of fixing—I mean, you've all commented on the fact that the General Schedule can work well, that the systems that were in place can work well if they got the right kind of resources and leadership behind them. Maybe speak for 30 seconds if you—anyone who wants to jump in—on your hope for how that can happen moving forward?

Ms. KELLEY. Well, I would hope that there is a recognition of the front-line employees that are there, and that they should be supported in the work that they're doing. You know, the overall question of pay for performance, at first blush it is a pretty good sound bite, and many Federal employees at first blush say, I'd love to be under a pay-for-performance system; maybe then I would be paid appropriately, equitable to the private sector. Then when they recognize pay for performance under this administration is about no more funding for the agency, so it goes to the name of the hearing today, robbing Mary to pay Peter and Paul, and also to the fact that managers will be—have this authority to decide who gets how much money without any accountability, then they recognize that it is a good sound bite, and that is all that is.

Mr. GAGE. I don't think this system will work. I don't think it is salvageable. I do think that many of the ideas that our union has

put forth, that Colleen has put forth about the existing GS, we can do a lot on that classification system. And it was really ironic to hear OMB and OPM say it is an outdated system, and it has to be scrapped, where we've been arguing for years that it needed to be adjusted, and it needed to be fixed. And to see them say, no, it so out—and they were the ones that were blocking trying to fix it in many areas.

But I'm very optimistic that I think that we can—now that this issue is so much on the table, that the ideas that we have for improving on the Civil Service can really maybe come forward again, and that we can put out some really positive ideas on how we can improve the Civil Service, protect the Civil Service, and really make our country terrific.

And one thing you said about it, Congressman, why would they do this or start this in DOD and DHS, you know, two of the most—well, we've got two wars going on, and our DOD employees are working mandatory overtime right on down the line. And DHS, 40 agencies coming together, the whole thing is a mishmash. And to try to overlay that with a new personnel system, I think, was really short-sighted and wrong.

Mr. SARBANES. Thank you.

Mr. JUNEMANN. I think one of the things that you brought up before that kind of addresses this really helps. Now, under DOD—because thanks to your legislation that the Congress pushed through, we actually sort of have a two-tier thing going on here. Where there is a union in place, they are still under the GS system. Where there is no union, they fall under the spiral thing.

Now, our union is not alone in this. We're involved heavily with recruiting, you know, college graduates. And we can really use and have used—when my members go out and meet with college grads to try to get them to come into the naval shipyards as a for instance, they can look at the GS system and say, OK, if you have a 3 point or higher, you start with a GS-7. You're going to move to a GS-9 over a certain period of time, and a year later you'll go to a GS-11. If you're under a 3 point, you start at a GS-5, and they can show them this is how you're going to move through the ranks. And if you're able to get into a more accelerated program, you can get into a GS-12, and here is how long that is going to take. And it works. I mean, it really works with people where they can see, OK, you know, I'm going to actually have to perform to do this, but there is guaranteed raises in there. There is a guarantee that if I do something, I can make it to the next level and the next level.

Under the spiral system, they don't have that. And I think what this is going to show, sort of the good news of all of this, is, you know, the agencies that are unionized, that are under the GS system, are going to find that they're able to actually recruit the best and the brightest because they're going to be motivated by this.

And I really need to speak to something I think that Dr. Tobias brought up earlier where he talked about the fact that money is not a motivator, yet—and we agree with that and—at least I do. I agree with that; however, I still say, well, this hurts morale. Well, because I think that the employees that I represent are motivated by the mission of the agency they work for, whether it is GAO, NASA, CRS, the Department of Defense, they're motivated by that,

that they see that their efforts make a difference and that they really—and that they have to make a difference, and that they really perform a service for the taxpayer. However, they also understand that—when they get cheated.

So it is not like that they are working for the money, but when it is not there, you know, when they're not adequately compensated, when suddenly they find that, you know—that the director of their agency gets COLA and they don't, you know, they feel cheated by that, and that is where the morale sets in. And that's when maybe they start looking around to other agencies or in the private government to maybe find something better.

So you can't have both with this. I mean, they're not motivated by the money under a merit system; however, you know, the lack of proper recognition in their paycheck also—you know, it hurts morale.

Ms. BONOSARO. Let's see, we need, I think, three things, and first is a behavior change, which I would be very surprised to see, but be very welcome, which is for those who are running these systems in the agencies at least with regard to Senior Executive Service to totally divest themselves of the notion that there is or should be a normal distribution curve of ratings, and to rate people honestly and these executives honestly and fairly. I think that would first go a long way to starting to fix this system.

But I do think that we need some structural changes. I mean, if you were a fully successful senior executive, and the OPM Director says that should be and is a very good rating, there is no reason you should be getting an annual pay adjustment that is far less than the people that you supervise. I mean, a 2 percent adjustment for a fully successful executive makes no sense.

I'm afraid that we're going to need legislation to fix those kinds of issues, including the—counting the performance of words in the high three and some other issues.

And there is a third issue. I think it is a long-range one, but it is getting shorter- and shorter-range every day, and that is how the General Schedule is—is creeping far into the SES pay scale, and that is turning off a lot of potential, really superb SES candidates. And we're going to have to take a look at that SES pay cap and see what we can do with it, because right now I think most rational GS-15s would say, why do I want the additional responsibility, fewer rights, no annual pay adjustment, no locality pay, etc? Yes, I love my job, I love my country, I love public service, but—so I think that is the third one we're going to have to fix, and it is a tough fix, but we're going to have to address it at some point.

Mr. SARBANES. Thank you.

Mr. DAVIS OF ILLINOIS. Thank you very much, and I have a couple of last questions.

Ms. KELLEY. You refer to the term “amorphous criteria” used in the SEC pay system. Could you explain what you mean by that term?

Ms. KELLEY. It is a criteria that is unknown to employees, it cannot be defined. In the SEC they call it an agency contribution factor, and in the FDIC they call it a corporate success factor, but no one can tell you what that is. They kind of describe it as “I'll know it when I see it.” And it has zero correlation to your performance

appraisal or your evaluation based on the requirements and criteria for your job. They intentionally delinked the rating to the—what they call a merit increase.

Mr. DAVIS OF ILLINOIS. Given—and perhaps this might be our last question. Given all of the problems and the controversy that we hear, one side I suppose we get certain kinds of arguments and discussions. From other sides, we get a different set of discussions and arguments and criteria. And, of course, we sit kind of in the seat where ultimately decisions have to get made. And if you were in the business of recommending to Congress that we do something about this controversy, what would your recommendation be? Perhaps we'll begin with you, Ms. Bonosaro.

Ms. BONOSARO. Well, our recommendation is attached to my testimony. We have a legislative package that we think will help fix this, because we really are concerned an awful lot of senior executives are eligible to retire and probably will go out. I mean, as we were saying earlier, pay is not the motivator, but it sure can be a demotivator when it is handled incorrectly. So I'm afraid that for us nothing short of getting that bill moving is going to do it, because just some of this is not going to happen without that, and they are the recommendations I mentioned earlier. So I won't take your time up with them again.

Mr. DAVIS OF ILLINOIS. Well, you know, the blues singers say the best things in life are free, but you can give it to the birds and bees because I need money.

Mr. JUNEMANN. And that is pretty much my answer. I think what it is going to take to fix this is funding; not only just funding for training—and I would say not to fix the pay-for-performance system, but to fix the GS system. You know, you're going to need additional funding for training. If there is going to be anything resembling pay-for-performance systems, whether they are at GAO or wherever, there has to be—it has to be properly funded.

If we're going to use a given pool—and let me use an example. And we tried discussing this with the DOD folks when we were going through the negotiations. What we do in the private sector is we negotiate a cap of money, and it is funded, you know. So we say, OK, everybody is going to get, you know, a 2 percent across the board, and then there will be merit above that, say, up to 6 percent. That money is funded because what happens otherwise is you've got the four of us going for three \$20 bills, and somebody is going to come up short. And that is what happens when you have this small capped pool where everybody can't win no matter what their performance is. And then what happens is—and we've alluded to it—is team work suffers, because if I see that she is not doing her job properly, and yet if I help her, if I train her, if I help make her look better, it might cost me my pay, you know, that can't work.

And this also even leads to, I think, the issue of training—I mean, the issue of safety, you know, within nuclear—within nuclear refueling, that if somebody again saw that they had made a mistake and they thought, geez, maybe I better tell somebody—and I'm not talking anything dramatic or drastic, but even if it is something small, you know, that they'd go back and tell their supervisor, I think I goofed something up here, we better go back and

take a hard look at it, and they know it's going to cost them money if they do that. You know, that is a position we really can't be in.

But I think the No. 1 thing that has happened—you know, a system like this, two things really. It has to be developed with the employees in mind, whether they're unionized or not. It works better when there is a union, but it has to be developed from the ground up with employee buy-in, and that means just have an idea, not throw a program at them and expect them to sign onto it. And then it has to be funded properly so that, again, the money is there to reward people, and money is there to train not only employees affected, but the supervisors who are doing the evaluations.

Mr. DAVIS OF ILLINOIS. Thank you.

Mr. Gage.

Mr. GAGE. Yeah. I'll be brief.

I think just two things. I think first the classification system, it really could be an opportunity to look at that and remove barriers that really stop people from moving up within the GS system because of really antiquated barriers which don't take into account how well the person works and how well they perform. It is just some qualification that has been in there for 30 years. Now, I'd like to see the classification system really tweaked and fixed. Now, I don't think you can remove it as a basis, though, of the Civil Service.

And the second thing, a real practical thing—and we've been trying to push this, you know, for years—is more use of this career ladder, a system that we already have in the government. Many agencies use them. It is very similar to pay banding, although it has set criteria for what you have to do to be promoted. And these things have really worked good. I don't know why we're moving away from things that have worked well into this unknown.

But, again, Mr. Chairman, I just think this pay for performance is built on false premises, and I don't think it will ever work. I think that putting as much time into the classification system and some techniques in the Federal Government would pay off much more than to continue on with this expensive disaster.

Ms. KELLEY. I would ask that if the GS system is not going to be the pay system for Federal employees, that the right to collectively bargain pay be given to the unions and the Federal sector, because if there is not going to be the GS system, a known and established system, then that's what should happen. We should have the right to collectively bargain.

The GS system is not perfect. There are changes that could be made to it to allow the agencies more opportunity to reward employees at the high end, and we have offered more than once to work with the agencies to adjust that system to those realities. They have never taken us up on that offer. We have given them very specific proposals on how the GS system could be used to be better able to attract, retain and reward. And without collective bargaining, there is nothing there that requires them to do that, to talk to us.

Funding is an issue because of the forced distributions that you see in all of these alternative pay-for-performance systems. To say that 25 percent of the employees will be given the top raise, well, if only 25 percent of the employees are performing at the top level,

then that's appropriate. But what if you have an agency with 60, 70, 80 percent top performers? Why penalize them because of a funding issue or having to take from one to give to somebody else? So I would ask for your help there.

I would also ask for any opportunity you have to hold agencies accountable for what they do with these alternate systems. You heard from the SEC today, a 2003 arbitration win, that they still have not made these employees whole who were harmed. You know, the idea that they have not stepped up to this issue, not made those employees whole and stepped up to the fact that they made the same mistake in 4, 5, 6 and 7, and here we are in 2008, and yet they think it is OK to be—you know, writing briefs to have the arbitrator tell them what the remedy will be. I think that is unconscionable. They should be held accountable for that and they are not.

And the idea that anyone points to SEC, FDIC or the IRS manager's pay banding as a success should be an opportunity for anyone who can influence this to say that these are all failures. And, you know, this sound bite needs to stop, and they really need to get down to the business of managing the work force and properly compensating and rewarding them, which they are not doing today.

Mr. DAVIS OF ILLINOIS. Well, thank you all so very much. Mr. Sarbanes, if you have no further—

Mr. SARBANES. I just wanted to say that I'm very excited about the prospects for doing the right thing going forward, because, you know, there is this phrase, if it is not broke, don't fix it. But a better way of saying that is if it is not broken, make it better. And there is no shortage of good ideas that you have identified in a very responsible way, which signals that if we get the kind of leadership in place at the levels where it can make a difference in collaboration with you in taking up the ideas that you've offered, we can really start to set a new standard and model as the Federal Government should, the kind of behavior that every business in society can emulate. So I'm very excited about what is to come based on what I've heard here today.

Thank you for the hearing, Mr. Chairman.

Mr. DAVIS OF ILLINOIS. Well, thank you all so much. We appreciate your being here, your testimony, your patience. And perhaps good, better and best; never let it rest until your good becomes better and your better becomes best. Maybe we'll end up with the very best system that decisions can make.

Thank you so much. This hearing is adjourned.

[Whereupon, at 5:25 p.m., the subcommittee was adjourned.]

